

Landscape after storm

Hungarian banking sector

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Budapest, May 12, 2017

Agenda

How did Hungary end up in this messy situation?

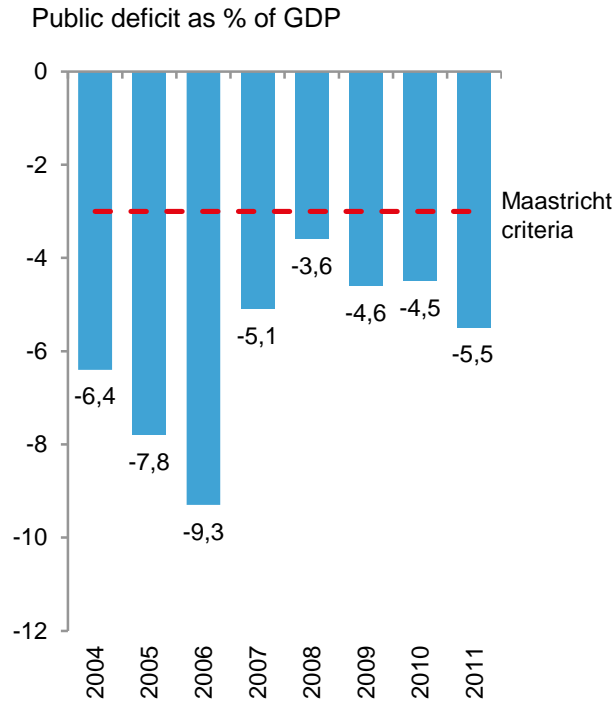
Impacts on the balance sheet of the banks

Why did banks started the clean-up only in 2014/2015?

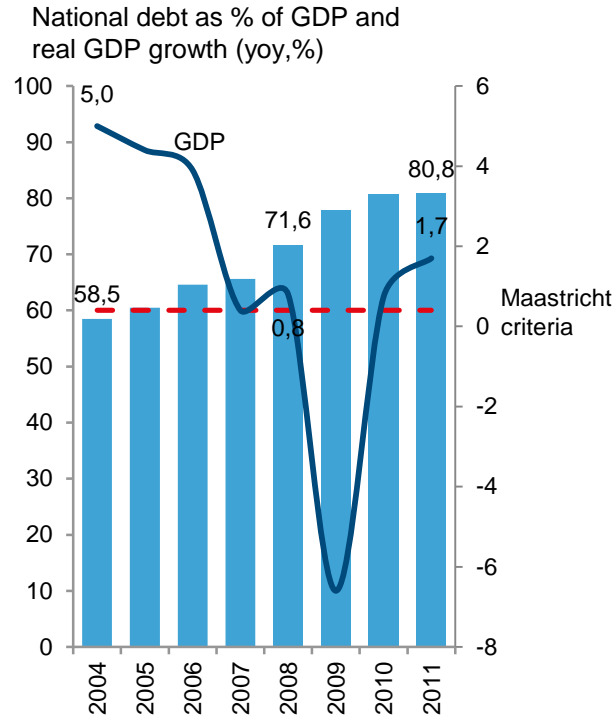
Results of the clean-up

In 2008, Hungary was by far the most vulnerable country in the CEE region

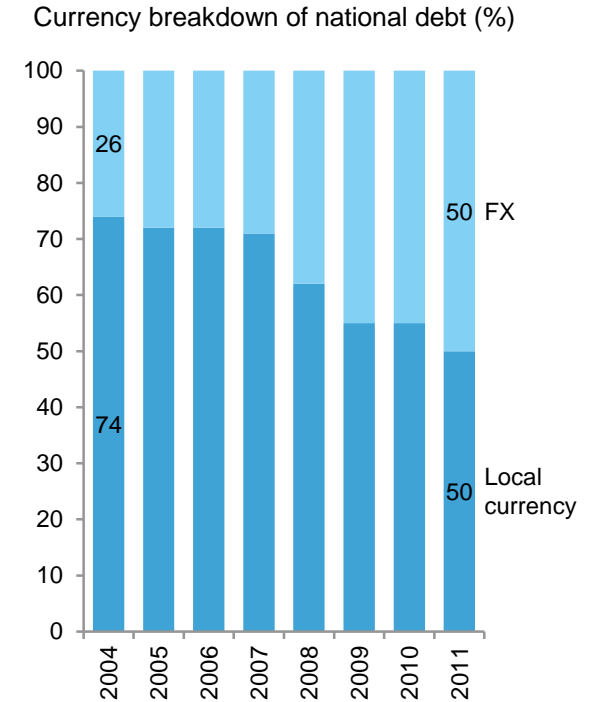
Public deficit over Maastricht criteria



Despite high GDP growth, debt increased even faster...



...and its structure was highly unfavorable

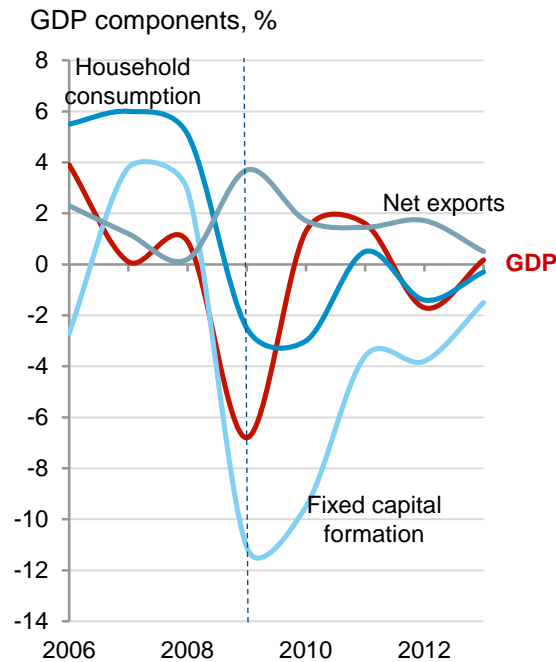


Hungarian economy had a huge dependence on external loans

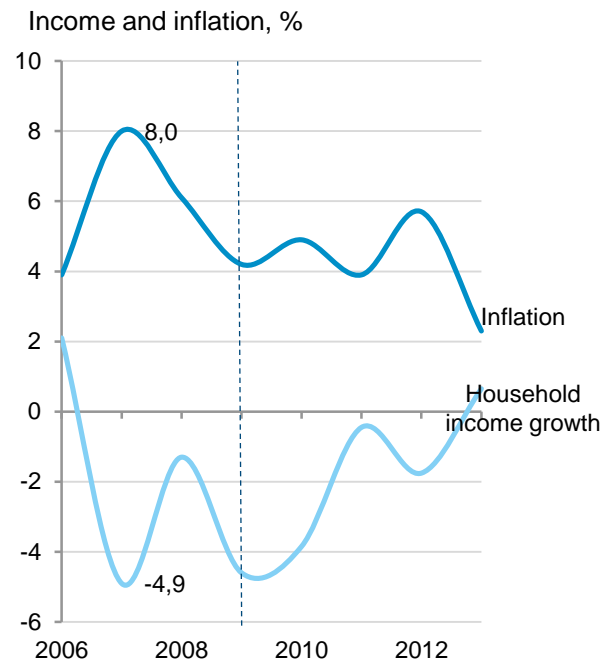
2009: macro hit rock bottom and revealed structural problems

FX debt, structure of growth, share of state spending, dependence on exports

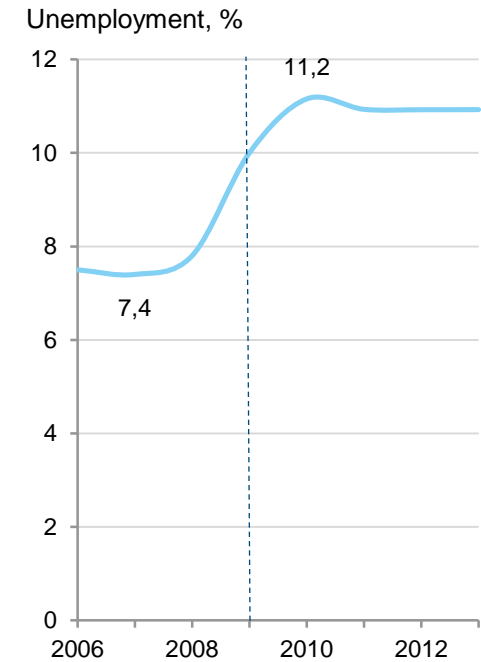
Drastic GDP decrease in 2009



Inflation high, while household income decreased



Unemployment rate hiked above 10%

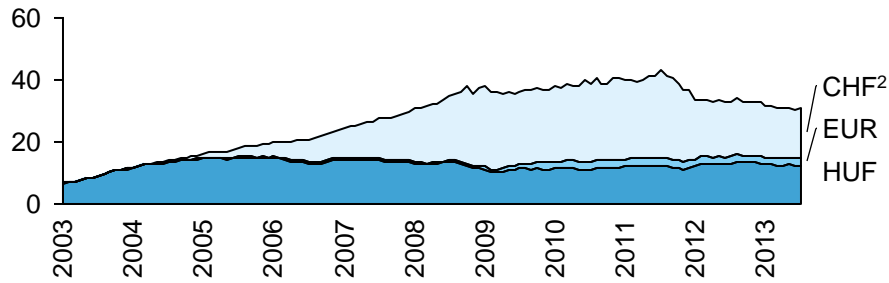


2009: USD 25 bn IMF and EU stand-by agreement and new government to manage crisis

Based on the currency distribution of mortgage loans, Hungary should have joined the „Swiss Monetary Union”

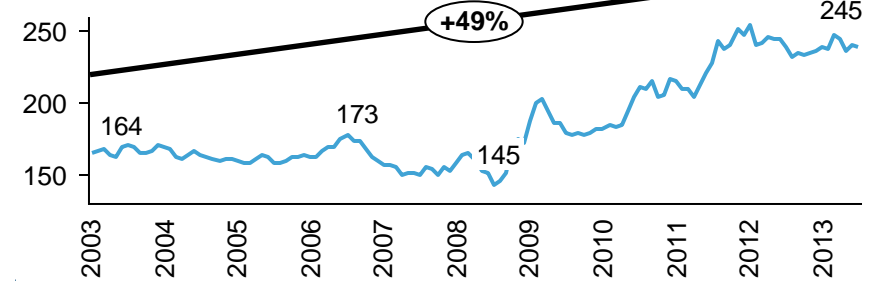
Share of FX in mortgage lending by the end of 2009 reached 71%, most of them CHF

Volume of outstanding mortgage loans¹ (bn EUR)



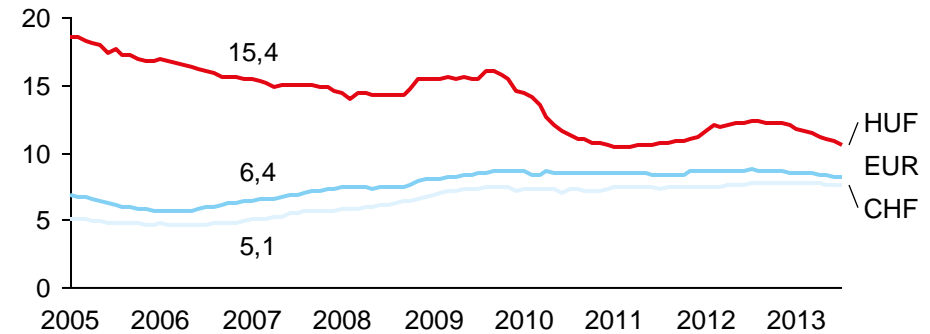
HUF depreciated substantially compared to CHF

CHF/HUF rate

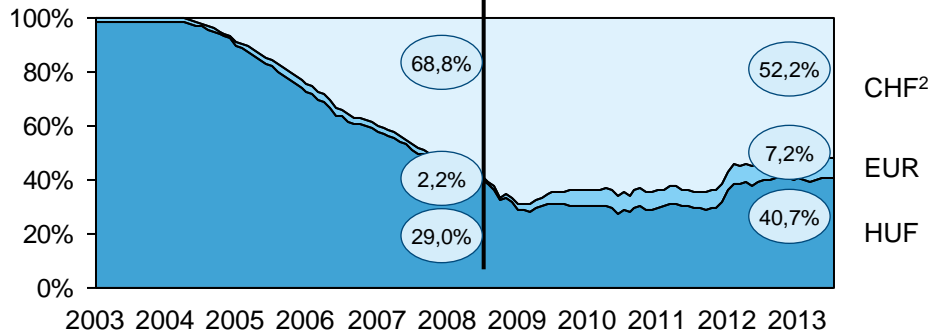


As the interest rate differentials between HUF, EUR and CHF were substantial

Average Interest rate of home equity loans³ (%)



Proportion of outstanding mortgage loans¹ (in %)



Banking sector L/D ratio around 150% in 2009

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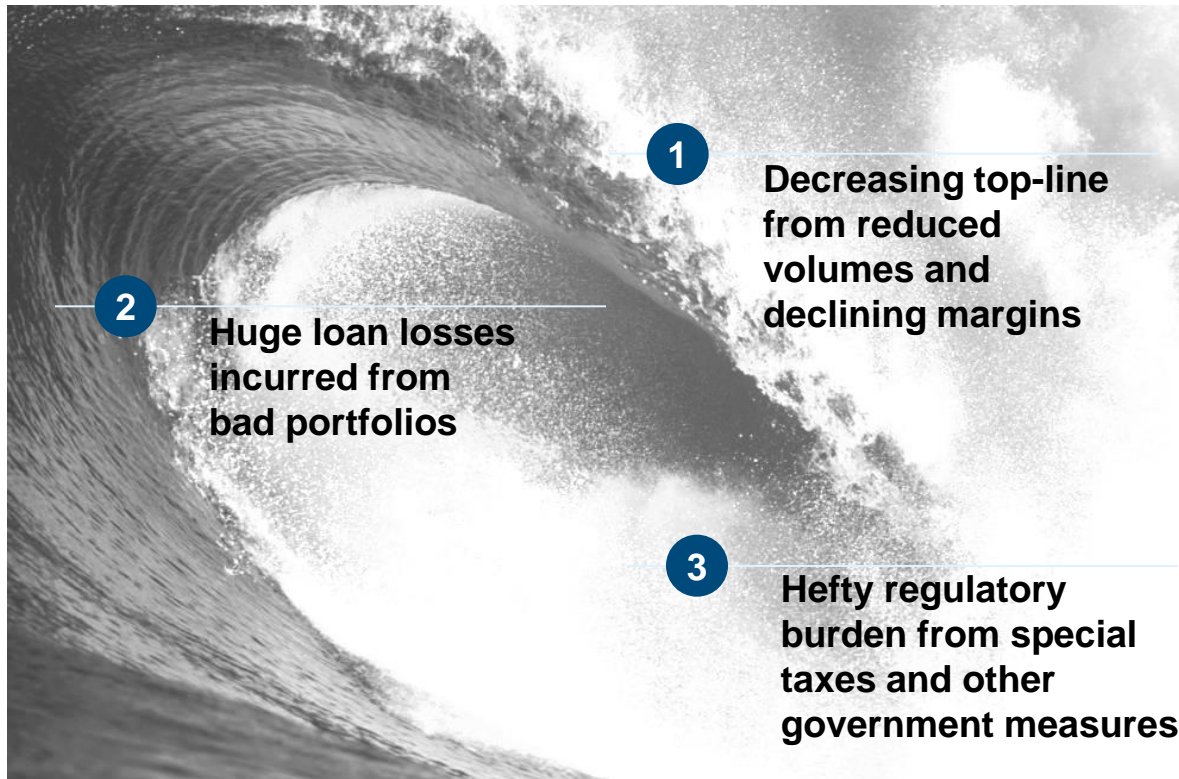
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Why did banks started the clean-up only in 2014/2015?

Results of the clean-up

Tsunami has hit the banking sector in three waves

'Tsunami' hitting the banking sector in three waves....



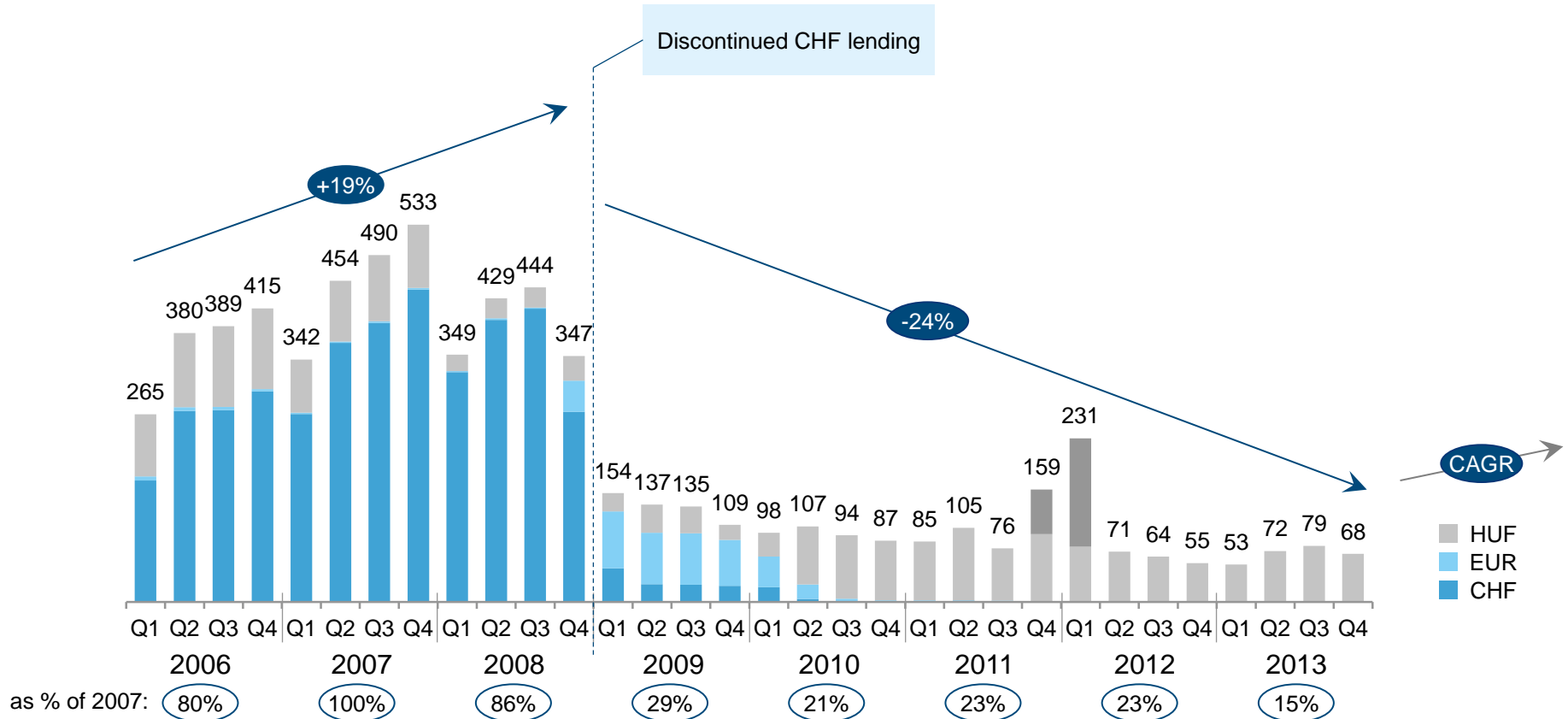
...causing freefall in the sectors' overall bottom line



1 Growth engine collapsed

Retail loan disbursement at around 20% of pre-crisis years

New loan disbursement on the Hungarian market (HUF bn)

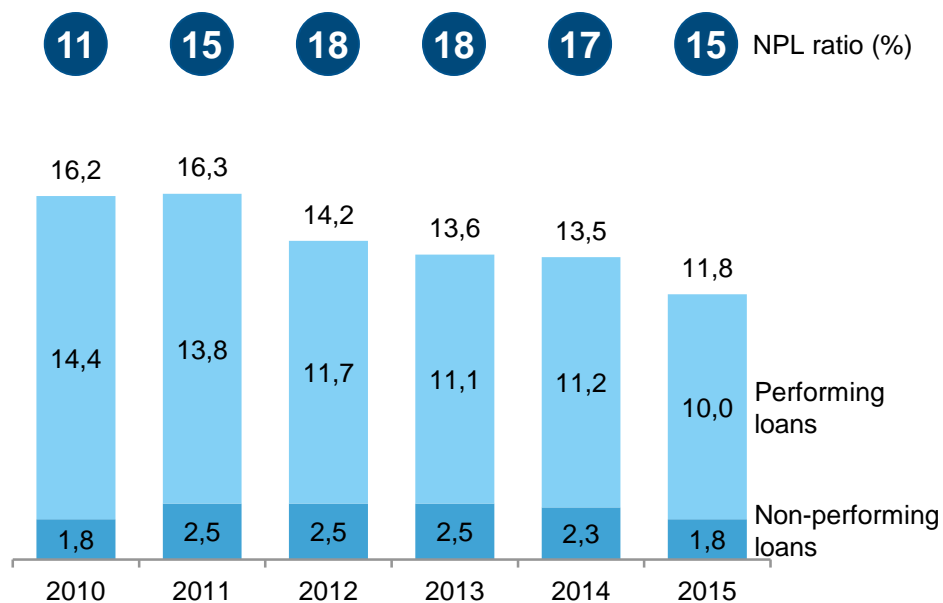


Very slow and fragile recovery

2 Banks have lost more than HUF 2,000 bn due to risk costs

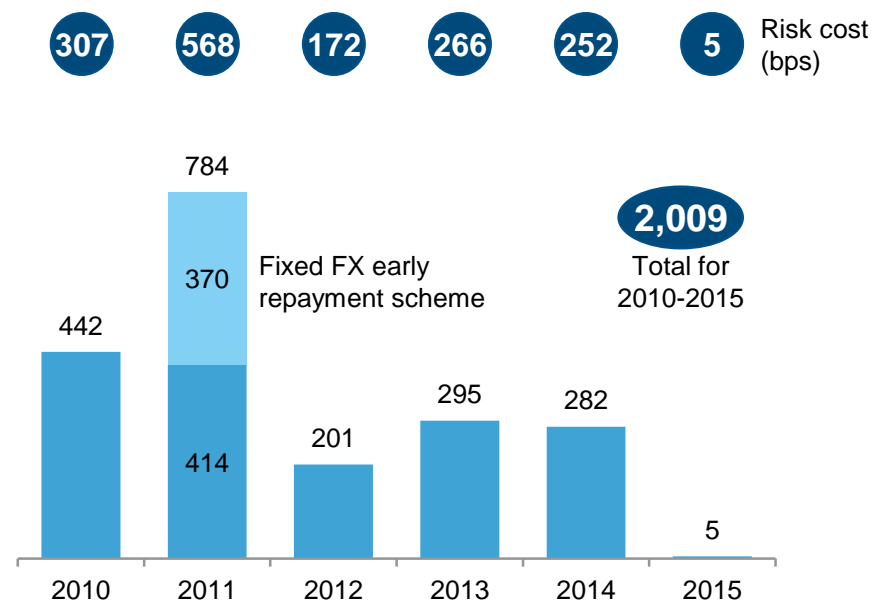
Volume decrease of HUF 4,400 bn...

Sector loan volumes (HUF '000 bn)



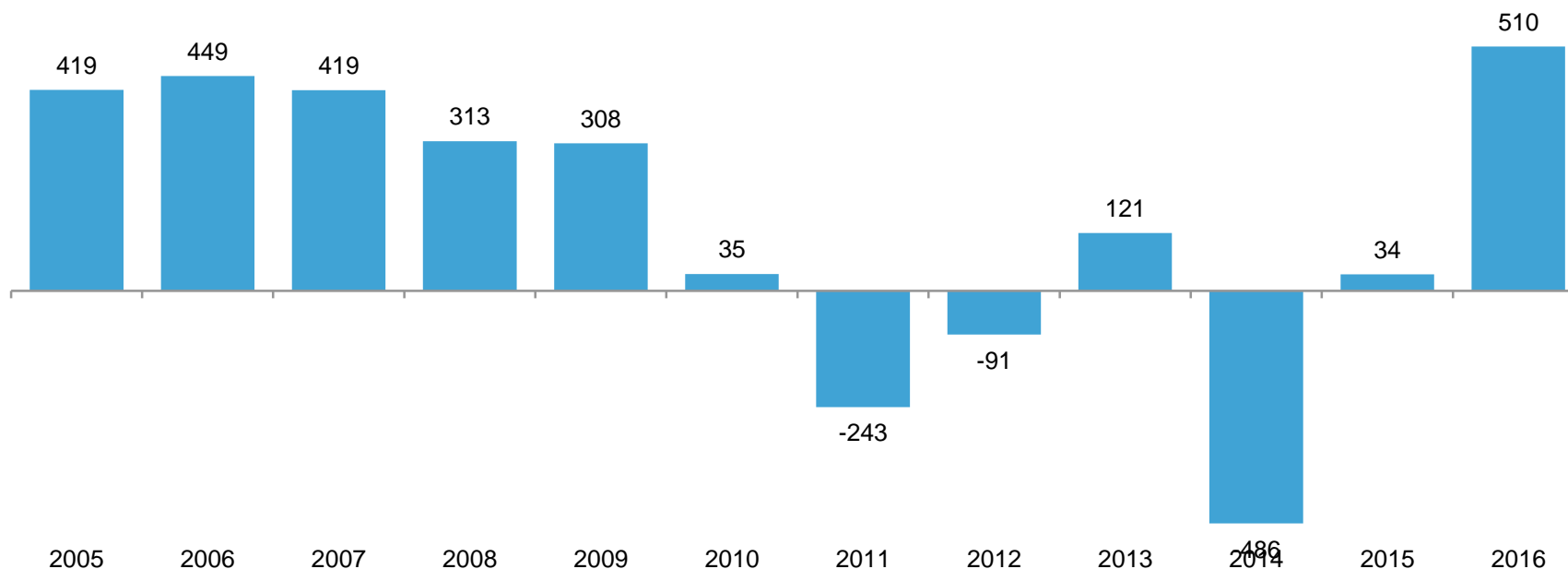
...caused some HUF 2,000 bn loss for banking sector

Risk costs of banking sector (HUF bn)



4 Banks' own mistakes and government measures resulted in losses of sector

Pre-tax profit of banking sector (HUF bn)



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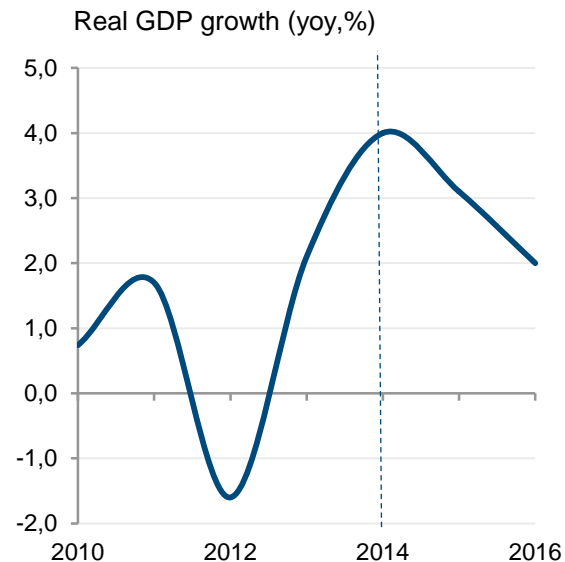
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Why did banks started the clean-up only in 2014/2015?

Results of the clean-up

Three factors were needed for banks to start clean-up

1 Overall economic growth



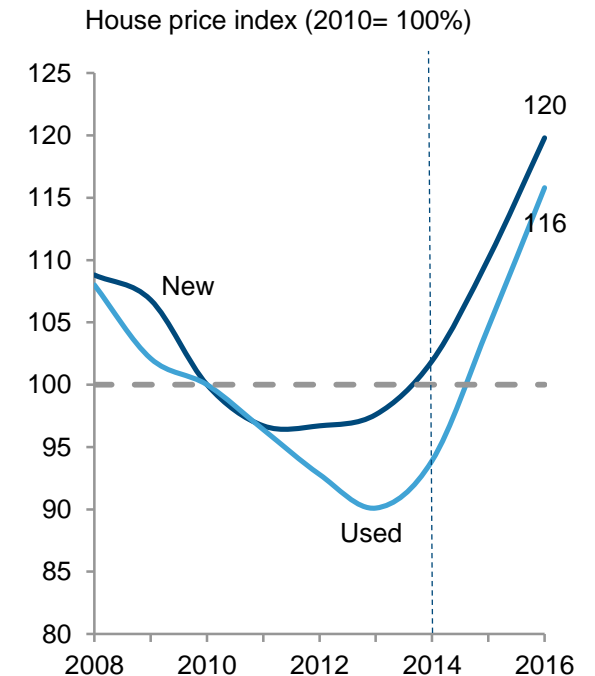
2 Stabilization of portfolio

Final solution for the FX

- 2011: Early repayment and FX cap scheme
- 2014: Settlement and Conversion laws based on Supreme Court ruling

Full control over the NPL portfolio

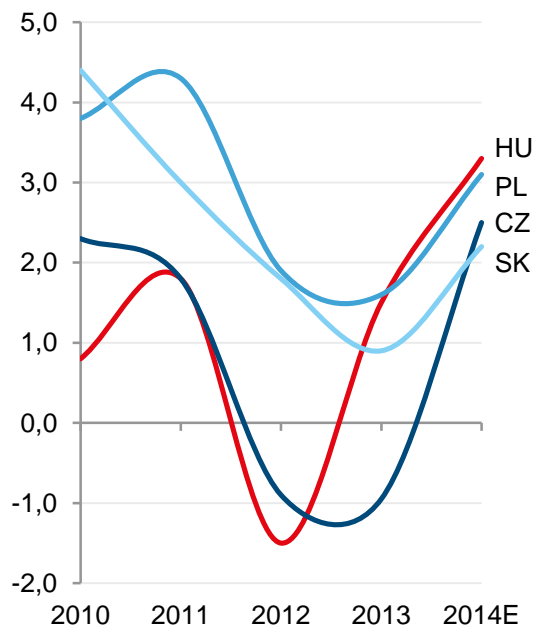
3 Real estate pricing momentum



1 Hungary's macroeconomic indicators have stabilized by 2014

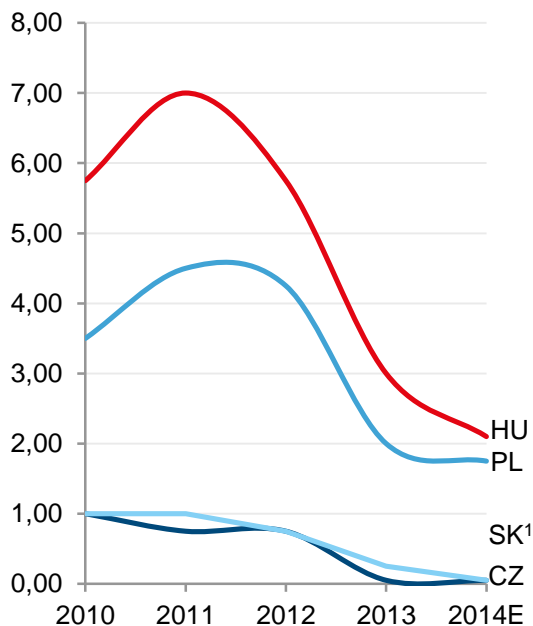
Growth rate over regional level

Real GDP growth (yoy,%)



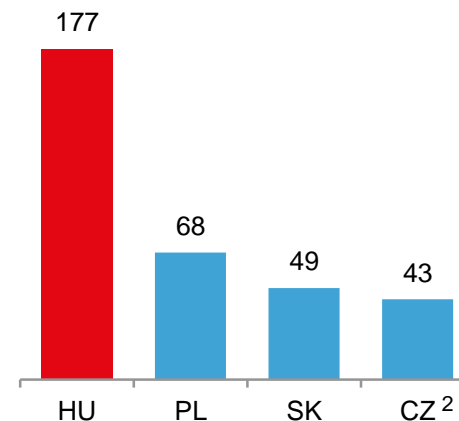
Base rate converged to regional figures

Base rate at year end (%)



Hungary is still risky for investors

CDS spreads (bps, Oct 2014)



Economic growth is essential for banking sector's improvement

2 2011: Early repayment and FX cap scheme introduced to solve FX lending problem

Law

Time frame

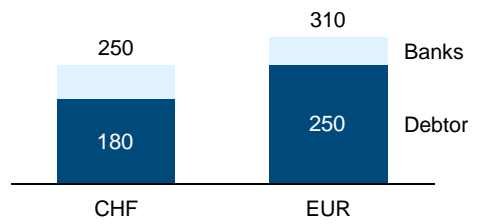
Eligibility

Participants

Total sector loss

Early repayment put a huge burden on banks but solved only part of the problem

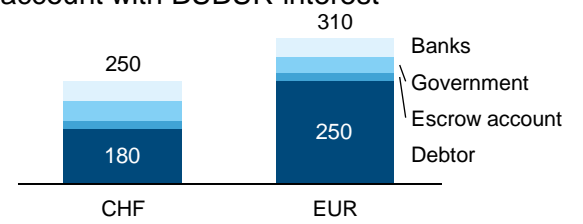
- Law approved by the Hungarian parliament allowed all FX debtors to repay their CHF/EUR mortgage loans at 180/250 HUF (although market rates were 250/310) in the period of October 2011-February 2012



- 2011 October – 2012 February
- All debtors
- ~170,000 contracts = EUR 4.5bn
- Immediately: EUR 0.9bn (~10% of the banking sector's equity capital)
- Future revenue loss over the repayment period EUR 0.9bn (EUR 200mn first year, decreasing over time)

FX cap scheme was more efficient

- Law approved by the Hungarian parliament allowed debtors to enter to a FX cap scheme (Repayment of FX debt as 180/250 CHF/EUR for 5 years). Above that rate a) interest payment shared equally by government and banks, b) capital is cumulated on an escrow account with BUBUR interest



- 2012 April (– 2017 April, end of 5 years)
- Debtors got a loan below 180 HUF/CHF
- Not in NPL
- Original loan below ~ EUR 80,000
- ~160,000 contracts (39%) = ~ EUR 4.5bn
- EUR 0.25bn

2 2014: Based on Supreme Court ruling government implemented Settlement and Conversion laws

	Issue	Ruling	Consequence	Law
1	<ul style="list-style-type: none"> Bid-ask spread at disbursement and instalments 	<ul style="list-style-type: none"> Bid-ask spread unfair, as “there is no service behind fee element” 	<ul style="list-style-type: none"> Difference between applied vs. MNB FX rates must be reimbursed to clients starting May 1st, 2004 	<ul style="list-style-type: none"> FX settlement (2015 Feb – May)
2	<ul style="list-style-type: none"> Unilateral increase of interest rates 	<ul style="list-style-type: none"> All unilateral interest increases unfair Banks have the right to defend measures in court¹ 	<ul style="list-style-type: none"> All interest increases after May 1st, 2004 that not proven fair in court must be reimbursed to clients 	<ul style="list-style-type: none"> HUF settlement (2015 Aug – Sep)
3	<ul style="list-style-type: none"> Entire FX risk is borne by debtor 	<ul style="list-style-type: none"> Only if (unlimited) risk taking is transparent to debtors from contract Econ minister: “by the end of this year all FX loans will be phased out of the economy” 	<ul style="list-style-type: none"> Conversion of retail FX mortgage-backed loans and leasing contracted between 1 May 2004 and 1 February 2015 Conversion rates: <ul style="list-style-type: none"> 256.47 HUF/CHF 308.97 HUF/EUR 	<ul style="list-style-type: none"> HUF conversion (2015 Feb – May)

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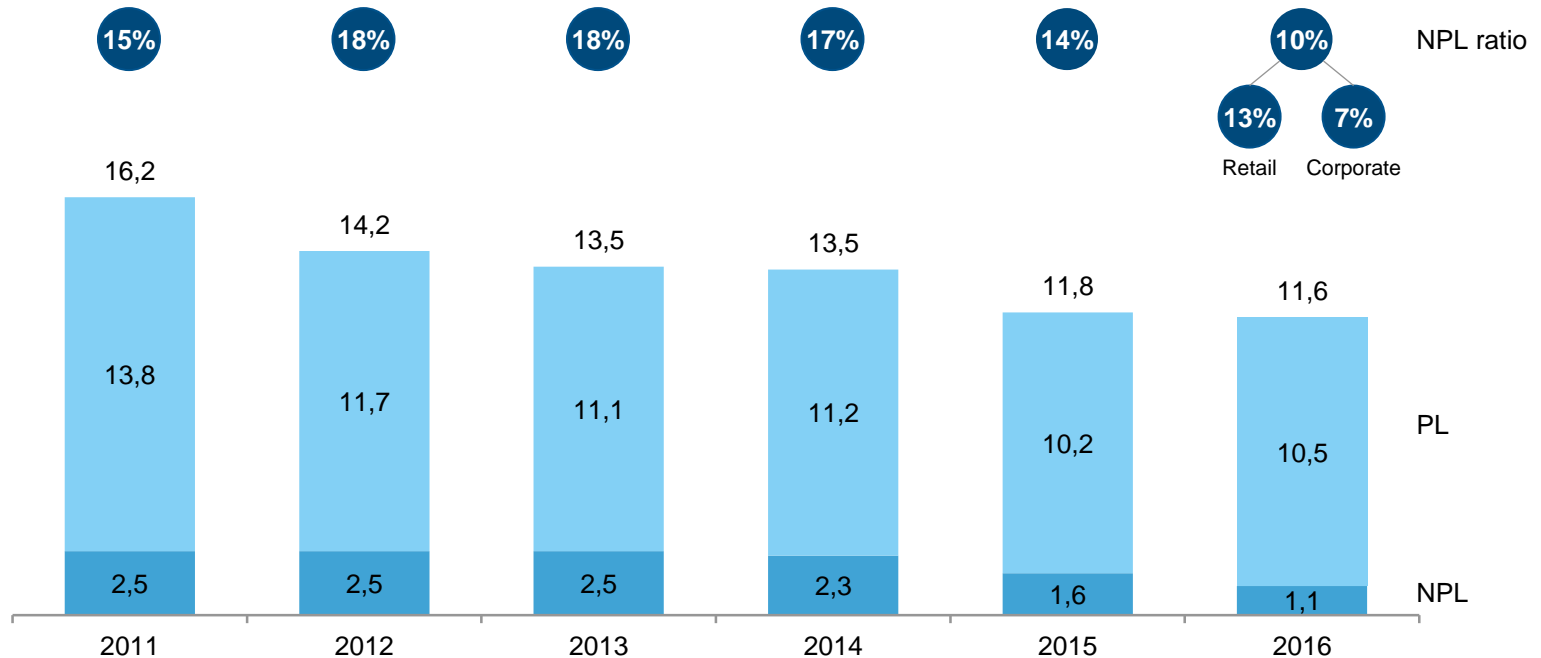
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Results of the clean-up

NPL ratio substantially decreased in sector

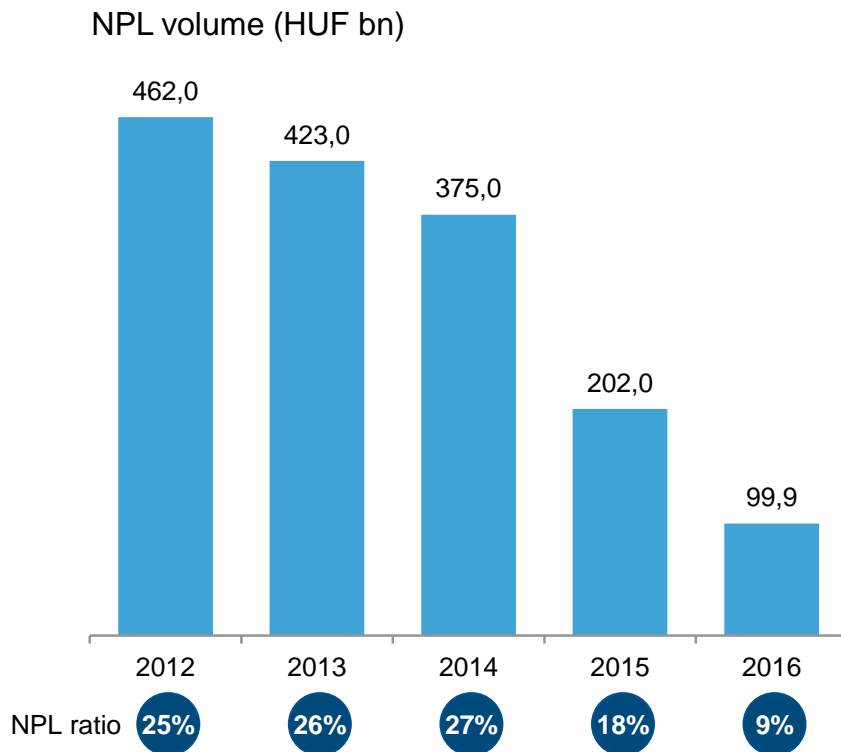
Further decrease expected after additional NPL stock sales

Retail + Corporate gross loan volumes (HUF '000 bn)



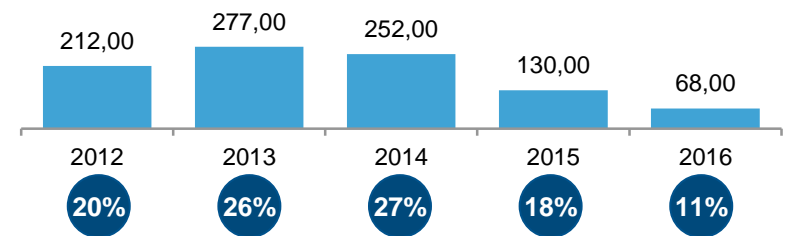
Substantial NPL decrease also at Erste

NPL ratio down to 9%:



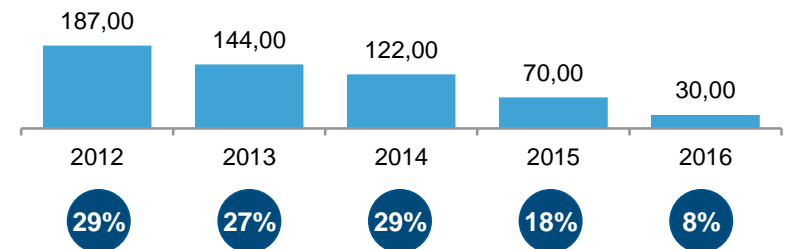
11% in Retail

Retail NPL volume (HUF bn)



8% in Corporate

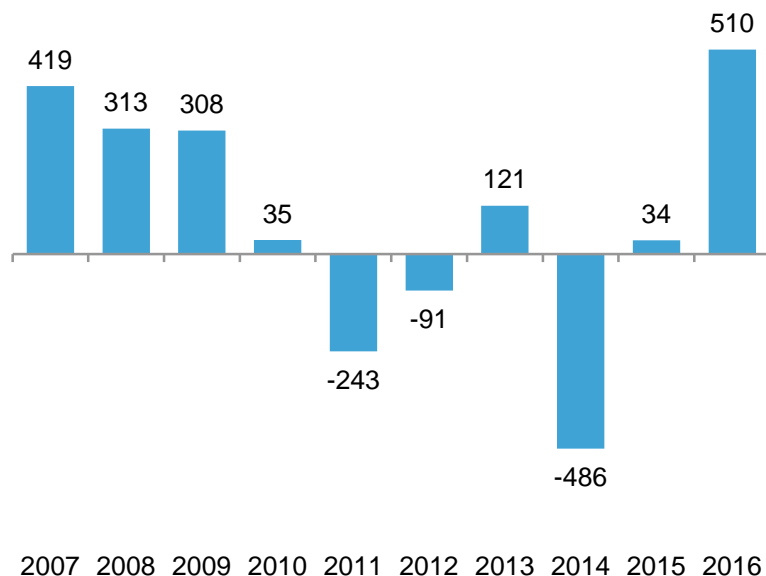
Corporate NPL volume (HUF bn)



Positive turnaround in the profit of the Hungarian banking sector with substantial one-offs

Regulatory decisions in the past affected the banking sector negatively

HU banking sector profit before tax (HUF bn)



Positive trend mainly due to one-off effects

One-offs

- Large risk cost release due to the substantial loan portfolio clean-up progress
- Banking tax reduction

Revival of business opportunities

- Increasing new lending both in Retail and Corporate (mainly personal loan and SME segment)