

State & Perspectives of the Hungarian financial sector



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Institutional structure

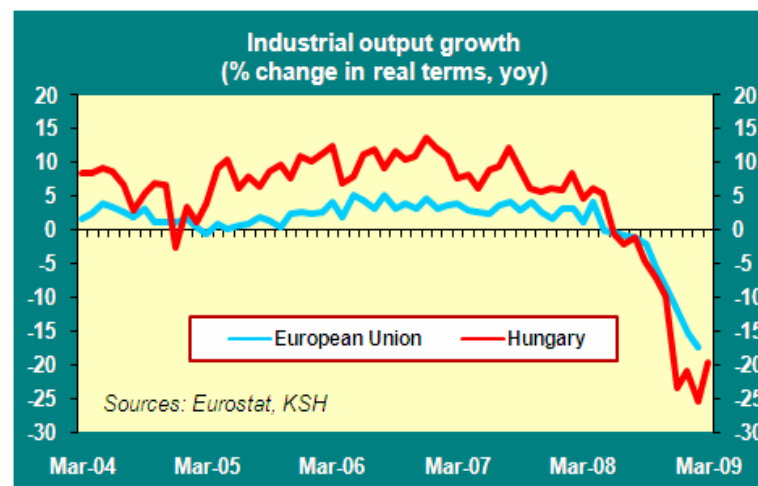
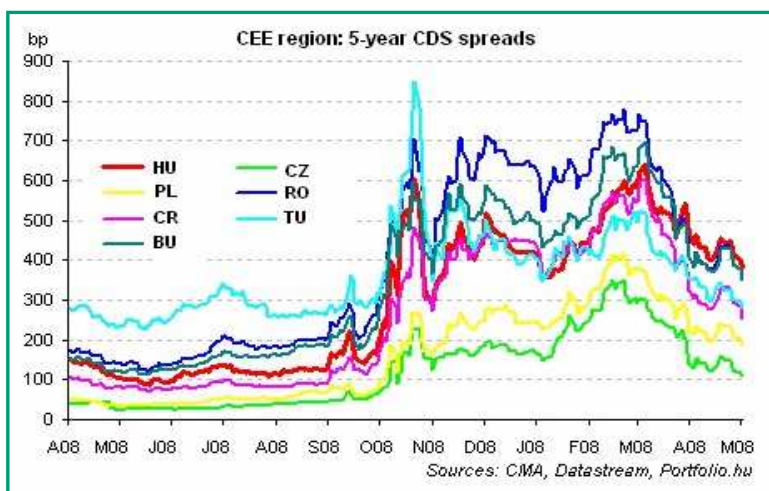
- ❑ Over 700 institutions and 1300 agents
- ❑ Numbers change together with relative profitability
- ❑ Investment services divided between banks & brokers
- ❑ Branches of non-resident institutions gaining importance

Hungary: Number of financial intermediaries

at period end	2002	2003	2004	2005	2006	2007	2008
Intermediaries, total	722	700	714	712	734	736	731
Banks, specialised credit institutions	35	36	35	34	37	37	36
Cooperative credit institutions	189	182	178	174	166	157	148
Branches of non-resident credit insitutions	0	0	0	3	4	6	11
Credit institutions, total	224	218	213	211	207	200	195
Financial enterprises	193	188	218	215	235	250	259
Credit market institutions, total	417	406	431	426	442	450	454
Insurance companies	31	30	29	28	27	30	33
Insurance associations	37	36	31	35	35	35	30
Branches of non-resident insurers	0	0	4	6	7	11	14
Insurers, total	68	66	64	69	69	76	77
Investment companies	25	24	18	17	17	17	21
Branches of non-resident investment companies	0	0	0	0	3	4	3
Asset managers	23	22	23	24	27	31	35
Pension and health care funds	189	182	178	176	176	158	141
Capital market institutions, total	237	228	219	217	223	210	200

Environment

- ❑ Global economy in deep recession, financial sector problems
- ❑ Global financial sector: tight liquidity and scarce capital
- ❑ Europe: same as global conditions, with 6-12 months lag
- ❑ Central Eastern Europe: correction for former overheating
- ❑ Hungary: structural weaknesses, expensive funds, recession



Key trends in 2008

- ❑ Significant slowdown of asset growth in 2008
- ❑ U-turn towards reintermediation – money goes back to banks
- ❑ Managed assets suffered large valuation losses
- ❑ Stagnating demand for insurance products

Financial sector: size, growth, structure & penetration by type of institutions and activities

End-period data	Stock data								Structure				Growth (yoy)							
	2001 HUFbn	2002 HUFbn	2003 HUFbn	2004 HUFbn	2005 HUFbn	2006 HUFbn	2007 HUFbn	2008 HUFbn	2001 %	2006 %	2007 %	2008 %	2002 %	2003 %	2004 %	2005 %	2006 %	2007 %	2008 %	
By institutions																				
Banks, specialised credit institutions	total assets	9040	10196	12861	14912	17559	20838	24376	29222	65.6	61.5	60.9	66.5	12.8	26.1	15.9	17.8	18.7	17.0	19.9
	assets in management**	303	711	1377	1144	1491	1809	2211	1468	2.2	5.3	5.5	3.3	134.8	93.8	-16.9	30.3	21.3	22.3	-33.6
	total	9343	10906	14238	16056	19050	22647	26587	30690	67.8	66.8	66.4	69.9	16.7	30.5	12.8	18.6	18.9	17.4	15.4
Investment companies	assets in management**	1176	1077	425	410	518	689	841	705	8.5	2.0	2.1	1.6	-8.4	-60.6	-3.3	26.1	33.2	22.0	-16.1
Asset managers	assets under mgmt**	711	950	964	1167	1985	2681	3353	2747	5.2	7.9	8.4	6.3	33.5	1.5	21.1	70.1	35.1	25.0	-18.1
Leasing & factoring companies	total assets	559	841	1260	1636	2014	2200	2675	3369	4.1	6.5	6.7	7.7	50.6	49.8	29.9	23.1	9.3	21.6	25.9
Insurers	total assets	763	927	1082	1413	1701	1956	2259	2206	5.5	5.8	5.6	5.0	21.5	16.7	30.6	20.3	15.0	15.5	-2.3
Pension & health care funds	asset value**	582	776	1014	1412	1899	2350	2807	2618	4.2	6.9	7.0	6.0	33.3	30.7	39.2	34.5	23.7	19.4	-6.7
Cooperative credit institutions	total assets	638	779	898	1053	1263	1360	1505	1577	4.6	4.0	3.8	3.6	22.1	15.3	17.2	19.9	7.7	10.7	4.8
Total assets in intermediation		13772	16256	19881	23149	28428	33882	40027	43912	100.0	100.0	100.0	100.0	18.0	22.3	16.4	22.8	19.2	18.1	9.7
- as % of GDP		90	95	105	112	129	142	157	164
By activities																				
Lending		10237	11816	15019	17601	20835	24397	28556	34168	74.3	72.0	71.3	77.8	15.4	27.1	17.2	18.4	17.1	17.0	19.7
Insurance		652	786	902	1174	1352	1418	1521	1563	4.7	4.2	3.8	3.6	20.6	14.8	30.1	15.2	4.9	7.3	2.8
Asset management		2883	3654	3960	4374	6242	8067	9950	8181	20.9	23.8	24.9	18.6	26.8	8.4	10.5	42.7	29.2	23.3	-17.8
Total assets in intermediation		13772	16256	19881	23149	28428	33882	40027	43912	100.0	100.0	100.0	100.0	18.0	22.3	16.4	22.8	19.2	18.1	9.7

* / excluding assets in custody; ** / at market value

Key trends in 2008

- ❑ Profitability fell across the board
- ❑ Excluding one-time factors – banks: 10.7%, insurers: 13.2%, investment companies: 25.4%, whole sector: 11.6%
- ❑ Narrowing interest margin, slowdown in growth, fall in capital markets, declining net fee income
- ❑ Loan losses added little extra burden

Profitability (ROE, %)

	2001	2002	2003	2004	2005	2006	2007	2008
Banks	14.9	15.0	17.1	23.4	22.3	23.0	17.9	14.3
Asset managers	16.5	19.1	15.2	15.8	13.4	10.7	10.8	10.1
Investment companies	24.5	28.0	30.0	29.4	25.0	20.4	24.3	16.9
Insurers	17.2	20.1	19.6	25.5	29.0	23.9	20.2	17.6
Financial enterprises	4.9	11.6	-19.2	-6.2	-1.7	29.6	30.4	33.8
Cooperative credit inst's	n.a.	39.2	45.1	50.0	56.8	63.9	68.7	n.a.
Sector average	15.3	16.5	17.6	23.8	23.3	22.9	18.3	14.9

Key trends in 2008

- ❑ Credit institutions: introduction CRD in 2008 resulted in significant one-time impact
- ❑ Capital adequacy index – banks: stable, cooperatives: moderate decline, insurers: moderate increase
- ❑ Existing capital buffers to cover increasing amount of risk

Regulatory solvency ratio and level of capital adequacy (on solo basis, %)

End-period data	2003	2004	2005	2006	2007	2008
<i>Solvency ratio</i>						
Banks	12.29	12.80	11.95	11.54	11.60	11.43
Cooperative credit institutions	15.40	15.95	15.57	15.32	15.82	13.67
Investment companies	59.20	61.15	94.38	37.39	30.24	n.a.
<i>Capital adequacy/1</i>						
Banks	153.7	160.0	149.4	144.3	145.0	142.2
Cooperative credit institutions	192.4	199.4	194.7	191.5	182.2	170.9
Investment companies	451.1	310.9	441.8	200.4	204.1	n.a.
Insurers	176.5	167.8	182.5	216.6	223.5	234.2
Sector average	160.0	163.2	155.6	152.8	153.1	149.9

1/ As percent of the regulatory capital requirement

Key trends in 2008

- ❑ Banks: profitability is decreasingly sufficient to capitalise a reasonable amount of risk expansion
- ❑ Reliance to external sources of capital growing
- ❑ Insurers: substantial capital buffers – but mark-to-market valuation of investments would give a different result

Internal capital generation

	2004	2005	2006	2007	2008
ROE (%)					
Banks	23.4	22.3	23.0	17.9	14.3
Cooperative credit institutions	15.8	13.4	10.7	10.8	10.1
Investment companies	-6.2	-1.7	29.6	30.4	33.8
Insurers	25.5	29.0	23.9	20.2	17.6
Total	23.0	22.7	22.6	18.0	14.7
Growth of required capital (%)					
Banks	16.5	17.4	19.2	19.8	16.8
Cooperative credit institutions	22.2	15.4	7.9	8.9	16.2
Investment companies	-34.3	-13.7	95.0	2.4	n.a.
Insurers	25.2	7.4	6.1	9.9	2.2
Total	17.2	16.1	17.7	18.4	15.0
Internally generated capital surplus (% points) /1					
Banks	6.9	4.9	3.7	-1.9	-2.5
Cooperative credit institutions	-6.4	-2.0	2.8	1.9	-6.0
Investment companies	28.2	12.0	-65.4	28.0	n.a.
Insurers	0.3	21.6	17.7	10.3	15.4
Total	5.8	6.7	4.9	-0.4	-0.3

1/ %-point difference between ROE and the growth of required capital

Crisis chronicle

- ❑ Post-Lehman shock in Oct08 led to break-downs in the HUF treasury and the interbank FX markets
- ❑ Prompt response in international assistance: EUR 20bn in IMF/EU/WB loans, EUR 5bn repo facility from ECB
- ❑ Bank support package enacted in Dec08, to provide government capital & guarantees up to HUF 600bn
- ❑ Measures by central bank, government & HFSA to provide liquidity, improve oversight, help banks & save debtors
- ❑ Recession deepened in Q109, market conditions (HUF, risk spreads, equities) worsened until March, improving since then
- ❑ New government since April, embarked on major fiscal correction & structural measures – short-term risk significant
- ❑ Credit growth fell to 0-5%, risk provisions up, but banks improved on cost, fees & trading - profitability holds up in Q109

Main risks

- ❑ Extraordinary high level of credit risk (FX loans, severe income and labour market shock)
- ❑ Persistently limited supply of funds, high risk spreads
- ❑ Scarce supply of capital, limited support from parent institutions
- ❑ Continued high market volatility, significant trend risk (currency, bond, equity and property markets)
- ❑ Increased probability of parallel and combined shocks (eg. liquidity, credit risk, market, etc.)
- ❑ Strategic risk: unusually unfavourable risk/rewards ratio, uncertain business outlook, need for defensive behaviour
- ❑ Customer protection: deteriorating business conditions may reduce the perceived relative cost of unfair market behaviour