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Central European Covered Bond Conference

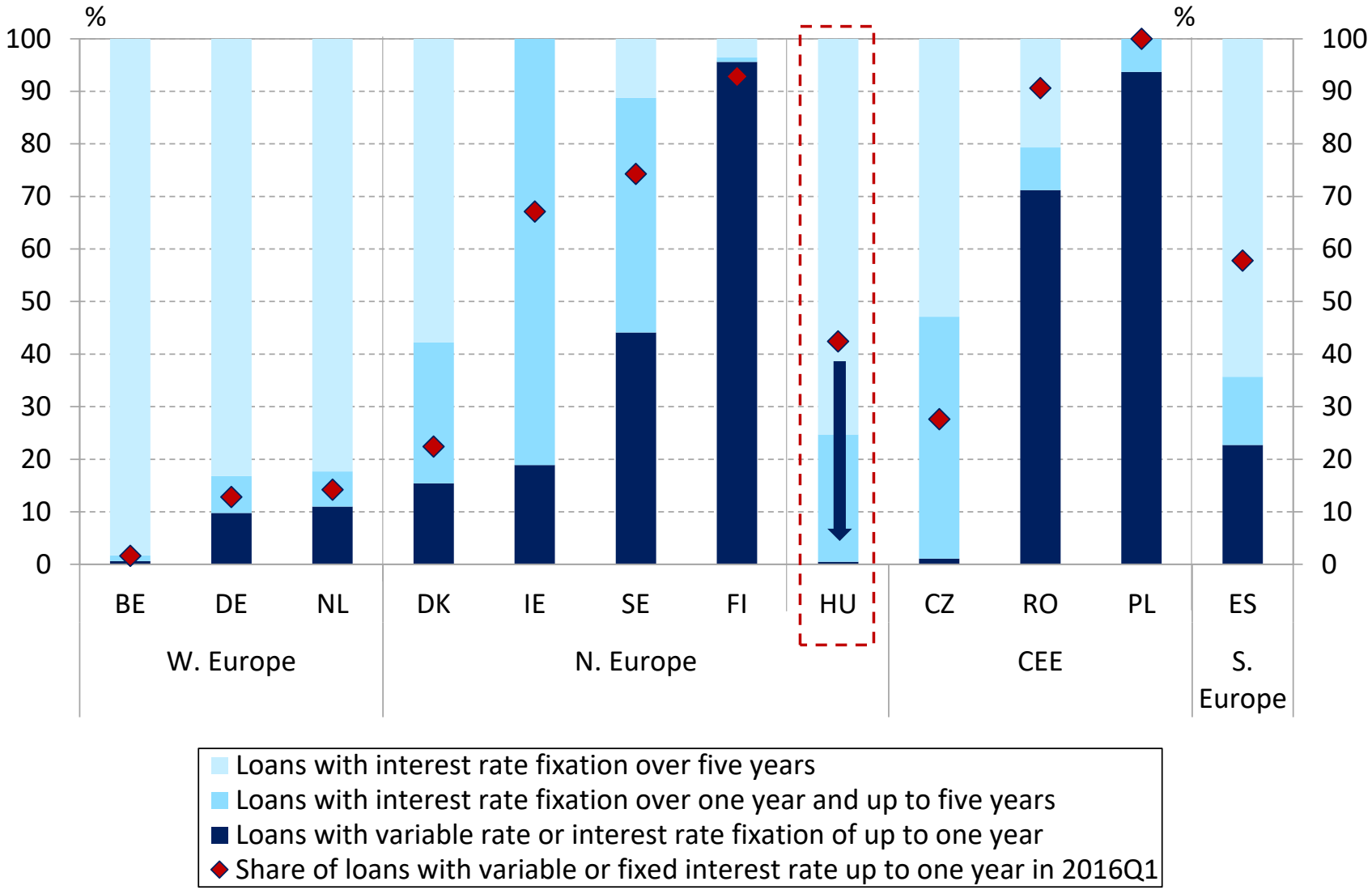
2022

MORTGAGE INTEREST RATE FIXATION

THE CASE OF HUNGARY

INTEREST RATE RISK OF MORTGAGES IN HUNGARY

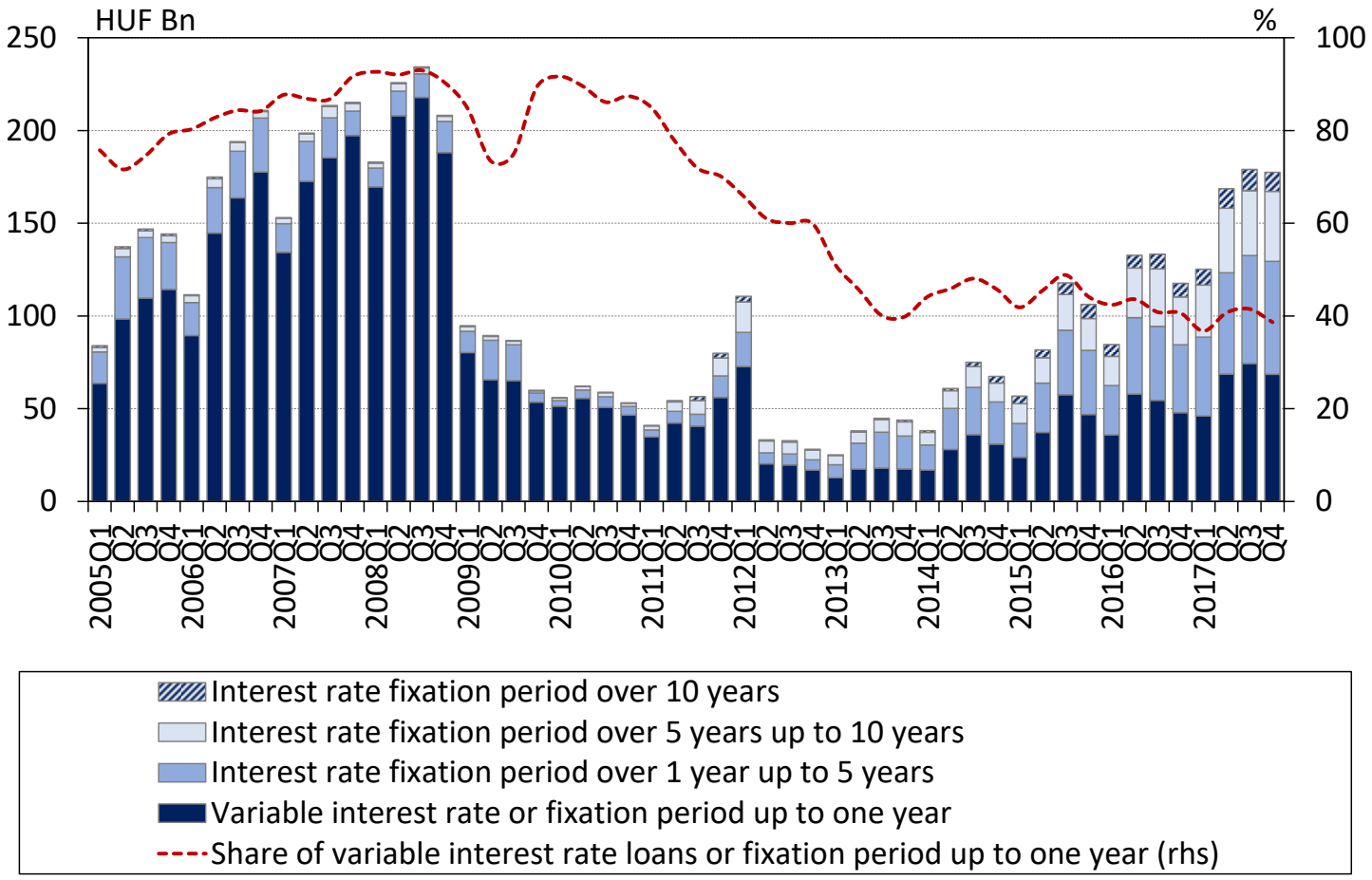
THERE HAS BEEN A GENERAL TREND TOWARDS LONGER INTEREST RATE FIXATION PERIODS IN MOST OF EUROPE IN THE PAST YEARS



New housing loans by interest rate fixation period (Q4 2021)

Source: EMF, MNB

PREVIOUSLY VARIABLE INTEREST RATE MORTGAGE LOANS PRONE TO INTEREST RATE RISK USED TO BE DOMINANT IN HUNGARY

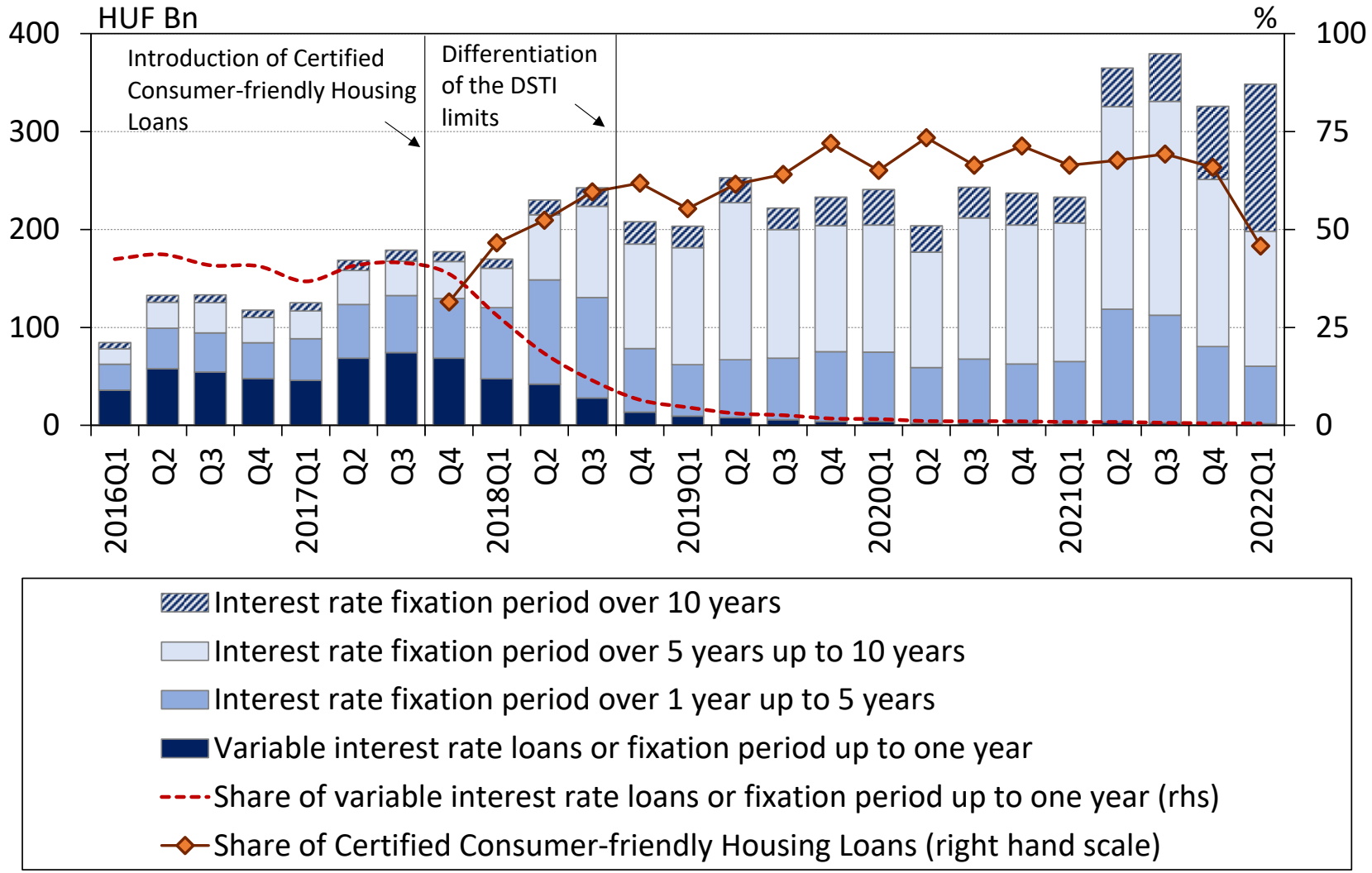


New housing loan disbursement by interest rate fixation periods until 2017

- **Mortgage loans have longer maturities → they are more affected by** interest rate risk.
- **In 2017 60 percent** of mortgages and **40 percent** of new mortgages had variable interest rates.
- **A 5 pps interest rate shock** on a typical 20-year mortgage **can cause the instalments to surge by 50 percent** and increase the average DSTI (approx. 30%) by 15 percentage points.*
- **Borrowers are usually unable to assess** the potential impact of **interest rate risk**
- They **tend to extrapolate the interest rates on the basis of past developments** (particularly risky in low interest rate environment).
- They **tend to outweigh the importance of the initial instalments** over the total repayable amount

Note: *In case of a 15 million HUF mortgage loans, 20 years of maturity, HUF 300k monthly net income, 4.5% initial interest rate.

THERE HAS BEEN A TURNAROUND IN INTEREST RATE FIXATION SINCE 2017 IN HUNGARY I.



- **Since 2019 the share of variable interest rate loans in new lending is negligible**
- **Interest rate fixation periods are becoming longer: 10-year fixation is the most widespread**
- **Some banks do not offer variable rate mortgages anymore**

New housing loan disbursement by interest rate fixation periods (2016-2022Q1)

Note: *Value in April for each year

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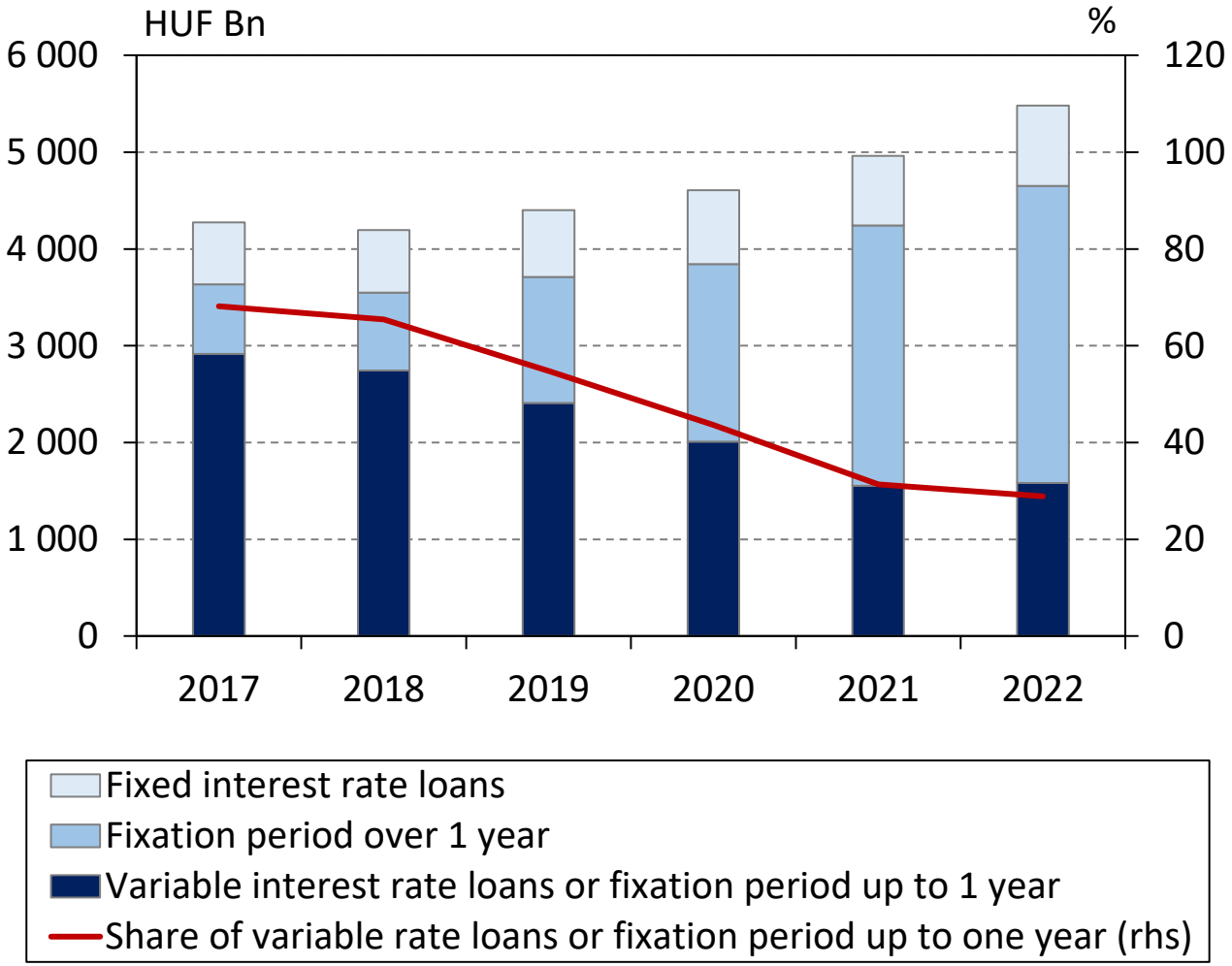


Outstanding mortgages by interest rate fixation periods*

- **By 2022 Q1 the share of variable rate mortgage loans has decreased to 29 percent → the current interest rate hikes have a moderate impact on systemic risk**
- **Low outstanding principal amounts and short maturities further decrease risks**
- **Currently, the „interest rate stop" measure shifts the costs of interest rate increases from borrowers to banks**

Note: *Value in April for each year

NUMEROUS MNB STEPS HAVE HELPED ALLEVIATE THE RISKS OF VARIABLE RATE MORTGAGE LOANS

The MNB's regulatory steps limiting interest rate risks of household mortgages

Borrower-based measures	Liquidity/funding measures	Supervisory measures	Other initiatives

BBMs were modified in October 2018 to cover risks related to floating rate mortgage loans. According to the modification, **lower DSTI limits were set for mortgage loans with interest rate fixation periods shorter than 10 years.**

The MNB's **mortgage loan funding regulation**, together with the **mortgage bond purchase program**, helped to revitalize **the mortgage bond market and reduce the costs of longer-term funding**, thus supporting fixed-rate mortgage lending.

An **MNB recommendation** was issued to notify borrowers about the **risks of variable interest rate mortgage loans** and to **incentivise the refinance** of these mortgages with borrower-friendly conditions.

In June 2017, the so-called **Consumer-Friendly Housing Loans certification program** was launched, under which **only mortgage loans with interest rates fixed** for at least 5 years **can receive a consumer-friendly rating.**

FUNDING INSTRUMENTS SUPPORTING FIXED-RATE LENDING

THE MNB SUPPORTS THE DEVELOPMENT OF THE MORTGAGE BOND MARKET WITH A MACROPRUDENTIAL FINANCING TOOL

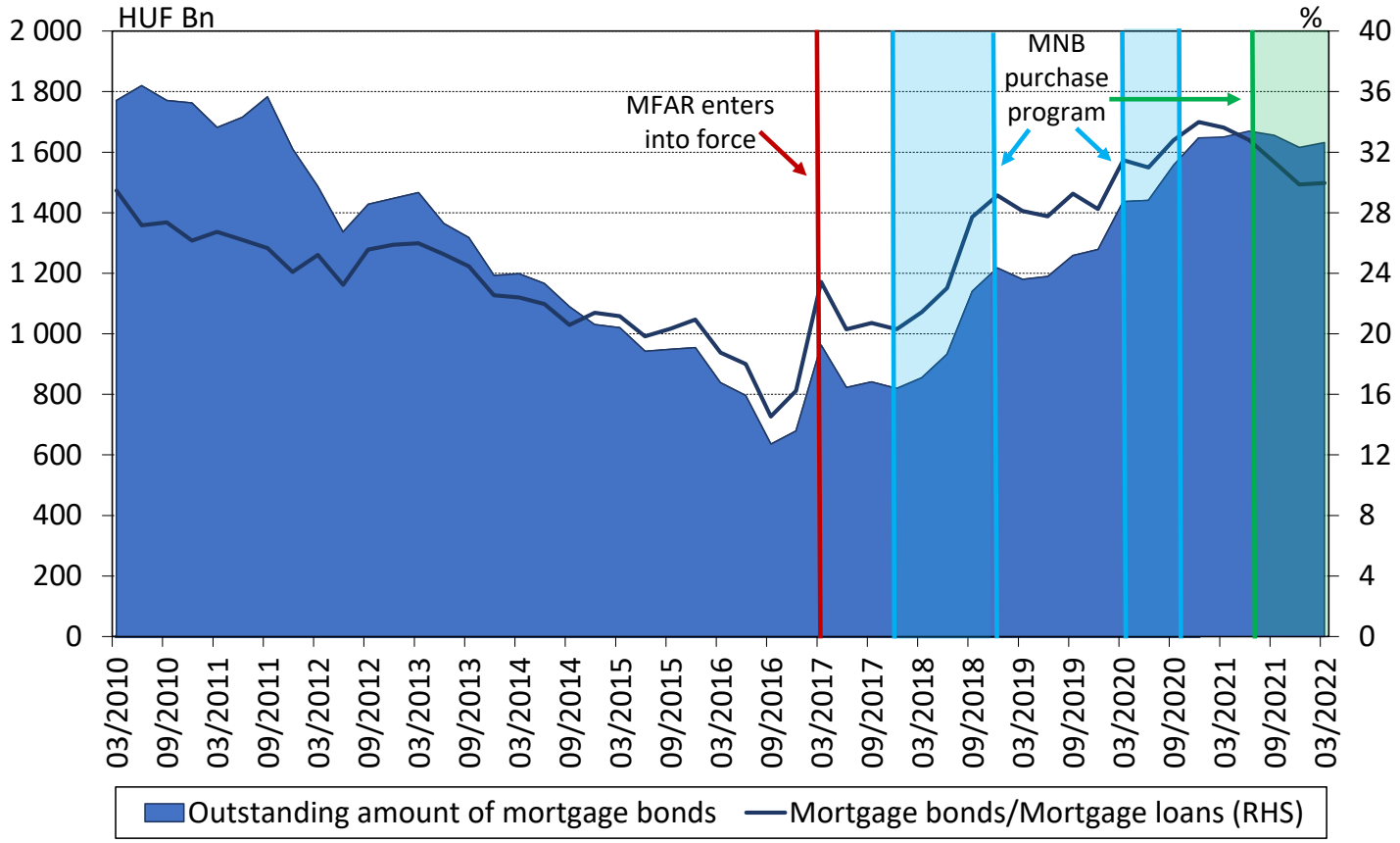
$$\mathbf{MFAR} = \frac{\textit{groups with mortgage banks} \quad \textit{groups without mortgage banks}}{\textit{mortgage bonds issued} \; - \textit{refinancing loans given} + \textit{refinancing loans recieved}}{\textit{household mortgage loans with a maturity over 1 year}} > \mathbf{25\%}$$

- The Mortgage Funding Adequacy Ratio (MFAR) expects banks to **finance forint household mortgage loans** with a remaining maturity of more than 1 **year in a certain proportion by long-term forint funds covered by household mortgage loans**.
- The goal is to **reduce banks' on-balance sheet maturity mismatches** on favourable terms and to support **mitigating their interest rate risk** with the increasing prevalence of loans with longer interest rate periods.

New developments regarding MFAR:

- From July 1 2021, **green funds get a preferential treatment in the ratio**: they can be taken into account with a 1.5 weight
- From 1 July 2022, **FX funds will be eligible too** with certain conditions in order to reach foreign investors (FX exposures to be hedged)
- From 1 October 2023, **the regulation will be tightened**: minimum level increased to 30%, cross-ownership of mortgage bonds between banks will be disincentivised

ISSUING MORTGAGE BONDS CAN BE AN EFFECTIVE TOOL BESIDES DERIVATIVES TO MANAGE INTEREST RATE RISK



Development of domestic outstanding amount of mortgage bonds and mortgage bond/mortgage loan ratio

Source: MNB

Mortgage bonds

- MFAR regulation & MNB mortgage bond purchase programme → increasing mortgage bond stock.
- **Fixed interest rate a requirement in purchase programme → 86% of the outstanding mortgage bond stock has a fixed interest rate**.

Interest rate derivatives (domestic market)

- **Outstanding notional amount was 25 trillion HUF** (~64 billion EUR) at end of 2021.
- Market participants' feedback shows **both market-making, speculative and hedging motivations.**
- **Counterparties are mostly non-residents** but in some cases this is because **parent banks act as intermediaries**.
- **Maturities of 5 and 10 years are the most active segments**.