MINISTRY OF FINANCE
STATE SECRETARY

Ref. no.: PM/854/2/2022

Mr. Francesco Mazzaferro
Head of the ESRB Secretariat
c/o ECB

Sonnemannstrasse 20
D – 60314 Frankfurt am Main
Germany

20 January 2022

Dear Mr Mazzaferro,

Thank you for your letter dated of 9 December 2021 notifying me about the ESRB's Warning. The ESRB *Warning ESRB/2021/15 on medium-term vulnerabilities in the residential real estate (RRE) sector of Hungary* explains that vulnerabilities stem from the high house price growth and the arising significant overvaluation mainly in the capital, the robust increase of mortgage credit and the amplifying effect of the government subsidies on the risk of overvaluation and household indebtedness. The ESRB acknowledges the macroprudential framework employed by the Magyar Nemzeti Bank (MNB) that mitigated the potential risks, namely the loan-to-value (LTV) and debt-service-to-income (DSTI) ratio regulations. I highly appreciate the ESRB analysis and assessment.

The Hungarian authorities are also regularly analysing the residential real estate sector developments, more so as this sector has become a key area of Hungary's economic, social and family policy. The modernisation of the present legacy residential real estate stock as well the improvement of the energy efficiency of RREs and the appropriate supply of dwelling possibilities for young families with several children are all key policy priorities of the Hungarian Government. The subsidized loans and other support mechanisms in this field limit the risks of borrowers rather than increasing them through low, fixed interest rates, public guarantees in some cases and the fact that they finance purchases for borrowers' own use. Thanks to these subsidies and as a result of the reintroduction of the preferential VAT rate on housing in early 2021, propensity to build new homes rose again, based on the number of newly issued building permits

Due to the elevated house price growth, the risk of overvaluation in the housing market might be present in Hungary. House prices have been growing since 2013 and more than doubled since then. The observed house price inflation was also accompanied by the dynamic increase of household credit, which has been growing since 2017 and by double digits since 2019.

Nevertheless, the potentially arising financial stability risks remain very limited due to numerous factors:

- Credit penetration relative to domestic GDP remains the third lowest in the EU: only Romania and Latvia had lower household credit-to-GDP ratios than Hungary, which was only 17 percent in Q2 2021.
- In addition, only less than half of the domestic residential real estate transactions are financed with housing loans and the exposure of banks towards the real estate sector is limited even in an international comparison. Within the loan portfolio of Hungarian banks vis-à-vis the private sector the share of retail mortgage loans was 25 percent in Q2 2021.
- Furthermore, the currently high credit growth can largely be attributed to the substantial demand for subsidized loans in line with the abovementioned Government policy and the significant share of loans under moratoria until November 2021. As the general moratoria ended in November 2021, its effect on credit growth has already largely been moderated.
- Despite the high credit growth, the material deterioration of lending standards cannot be identified. The DSTI and LTV distribution of new loans remained stable: around 35 percent of new housing loan contracts were disbursed with DSTI values higher than 50 percent or LTV values of more than 70 percent in recent years.

Besides the Ministry of Finance's regular analysis the MNB also regularly reviews and communicates its assessment on the financial stability risks and the macroprudential policy measures taken concerning the RRE sector in various public reports. In these reports, the MNB presents detailed analyses on the residential real estate market and household lending, flagging any emerging risks that may require attention. The central bank has regularly warned about the increasing risks of potential residential real estate market overvaluation mainly in Budapest, and concluded that the potential financial stability risks remained contained. The MNB has also emphasized that its borrower-based measure (BBM) framework applicable since 2015 has successfully contained the build-up of excessive household leverage and indebtedness, and maintained an adequate income and collateral buffer, hence increasing the shock resilience of both the borrowers and lenders. In line with its risk analyses, the central bank in its capacity of macroprudential authority has not deemed it necessary to tighten its BBMs or to take other steps, such as raising the Countercyclical Capital Buffer requirement so far.

Obviously, should the current lending and house price dynamics persist in the medium term the eventually arising financial stability risks, after thorough analysis, might lead to regulatory or macroprudential interventions.

The Ministry of Finance, as the responsible authority for financial regulation and for economic policy setting, is very keen to avoid any negative real economy impact due to any eventual financial stability risk. The implementation of macroprudential measures is at the discretion of the MNB once the development of cyclical financial stability risks should warrant any intervention. A legally binding and well-functioning BBM framework is already in place in Hungary, as the Warning also underlines it, and the current lending situation does not warrant its tightening according to the central bank. At this stage we are confident that relevant developments and the potential risks are under full control. Would those risks increase in the medium term, the macroprudential measure to be considered by the macroprudential authority may include potentially the gradual increase of the countercyclical capital buffer aiming to further strengthen the resilience of lenders.

MINISTRY OF FINANCE
STATE SECRETARY

The Ministry of Finance, in cooperation with the MNB, will continue to closely monitor the Hungarian residential real estate sector taking into account all of its aspects, including the financial stability risk component. The Hungarian authorities will take the appropriate measures that they deem necessary when warranted.

Yours faithfully,

Gabor Gion

Pénzügyminisztérium
5.

H-1051 BUDAPEST, JÓZSEF NÁDOR TÉR 2-4. • PO BOX: H-1369 BUDAPEST, PF. 481. • PHONE: +36 1 795 1400