The impacts of the Funding for Growth Scheme on the financial sustainability of the Hungarian SME sector

KATALIN VARGÁNÉ KISS

The Hungarian economy was hit hard by the financial crisis. Within the corporate sector mainly SMEs suffered from the lending constraints of credit institutions. Therefore, it became utmost important to relieve the financing burden of the SME sector.

The Funding for Growth Scheme initiated and implemented by the central bank through the participating commercial banks acted as a provider of various fixed-rate, long-term loans with favourable conditions. The paper highlights how the FSG has contributed to SMEs’ access to financing by using documents and data published by the Hungarian Central Bank.

The Funding for Growth Scheme – A general overview

The Hungarian National Bank (MNB) announced the Funding for Growth Scheme (FGS) in April 2013 with a view to ease SME lending and to strengthen financial stability and reduce external vulnerability. Until its gradual phase out in March 2017, the scheme offered the most favourable conditions in terms of loan costs, the wide scope of its utilisation, the highest available loan amount, and its long tenor.

The scheme was available in three phases with different objectives to support SMEs to have access to forint-denominated loans. Within the framework of Pillar I of the 1st phase (from June to August 2013), the MNB provided refinancing loans at 0 per cent interest to the participating credit institutions, which could lend further these loans to SMEs with an interest margin capped at 2.5 per cent. These loans could be exclusively used for investment, working capital financing, pre-financing EU funds, or for the redemptions of existing forint loans for such purposes. Loans received under Pillar II could be used for the redemption of foreign currency loans. Credit institutions involved in the Scheme were either direct partner banks of the MNB or other banks, integrated savings co-operatives or credit unions that could participate indirectly through their umbrella banks [MNB, 2014a].

During the 1st phase, the ratio of refinancing loans was extremely high; these loans accounted for all of Pillar 2 and 40 per cent of Pillar 1 [László, 2016], in the second phase from October 2013 to the end of 2015, new loans accounted for around 95 per cent of the loans granted, and nearly 60 per cent – HUF 815 billion – was intended to finance new investments directly. The participating credit institutions provided loans to nearly 27,000 micro, small and medium-sized Hungarian enterprises, amounting to a total of HUF 1425 billion. In the 2nd phase most loans were taken out by micro enterprises both in terms of number and volume, with the vast majority of the loans intended for investment purposes. Under Pillar 1 of the 2nd phase new investment loans, working capital loans and EU loans were disbursed, while under Pillar 2, SMEs could still take out loans for the redemption of forint and foreign currency loans [MNB, 2016]. During the third phase from January 2016 to March 2017 the Scheme offered only new investment loans and leasing transactions both in forint and foreign currency, while working capital financing and redemption of existing loans were not possible. Within the HUF 684.9 billion contracted loan amount, the share of new investment loans was 78 %, whereas that of new leasing transactions amounted to 22 % [MNB, 2017a].

1 This paper was written in the framework of EFOP-3.6.1-16-2016-00017 project entitled “Internationalisation, initiatives to establish a new source of researchers and graduates, and development of knowledge and technological transfer as instruments of intelligent specialisations at Széchenyi István University”

2 Associate professor, Széchenyi István University, Centre of Foreign Languages. Email: kathykis@sze.hu
Table 1 demonstrates a comprehensive overview of the objectives over the course of the whole Scheme together with the disbursed amount of loans under the two pillars. The presented information and figures indicate that the scope of loan objectives gradually narrowed; with a shift towards investment loans both in HUF and foreign currency. The largest amount applied for by SMEs was available during the 2nd phase, while a sharp decrease in the disbursed amount during the 3rd phase may suggest the gradual encouragement and strengthening of market-based lending.

### Table 1: Objectives of the FGS

<table>
<thead>
<tr>
<th>Phase</th>
<th>Pillar 1</th>
<th>Pillar 2</th>
<th>Total amount of loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st phase</td>
<td>new investment loan</td>
<td>refinancing of FX loans or FX-based loans with HUF loans</td>
<td>HUF 701 billion</td>
</tr>
<tr>
<td></td>
<td>working capital financing</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>pre-financing EU funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>refinancing of HUF loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2nd phase</td>
<td>new investment loans</td>
<td>refinancing of HUF loans</td>
<td>HUF 1425 billion</td>
</tr>
<tr>
<td></td>
<td>working capital loans</td>
<td>refinancing of FX loans</td>
<td></td>
</tr>
<tr>
<td></td>
<td>pre-financing EU funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3rd phase</td>
<td>new investment loans in HUF</td>
<td>new investment loans in FX</td>
<td>HUF 685 billion</td>
</tr>
<tr>
<td></td>
<td>new leasing in HUF</td>
<td>new leasing in FX</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Complied by the author based on MNB data*

**Changes in corporate lending in parallel with the Scheme**

There are several factors that may directly or indirectly elucidate the positive developments in corporate lending during the implementation period (June 2013 – March 2017). Such indicators include changes in the Financial Conditions Index (FCI), the growth in new corporate loans, as well as the changes in credit conditions.

Based on the Financial Conditions Index, which summarises the monetary conditions and the lending developments both in the corporate and household segments, the cyclically restraining impact of the banking sector’s lending activity ceased completely by the time the Scheme had been phased out. Accordingly; in terms of the annual expansion in the real economy, neither a cycle strengthening, nor a growth restraining behaviour was experienced [MNB, 2017b].

Figure 1 illustrates that a considerable GDP growth (3.9%) from Q4 2013 on with slight fluctuations in between until Q3 2017 (3.9%) resulted in an improvement of the FCI. After a serious setback due to the crisis (2008-2012) the revival of the GDP growth seems to coincide with the launch of the FGS. During the overall time period of the Scheme the growth remained steady with slight fluctuations.
Corporate lending started to pick up in the second half of 2013. However, as Figure 2 reveals that until Q2 2013 the growth rate of loans to SMEs lagged behind that of other corporations. Over the course of Q3 2013 to Q2 2014 their growth rate of SME loans exceeded that of the whole corporate segment. After a short setback from Q4 2014 on, lending to SMEs started to produce a steady increase. From Q2 2015 on the growth rate of SME loans surpassed that of the corporate sector gradually maintaining a more than 5% gap. This also underpins the fact the launch and implementation of the Scheme boosted SME lending. In 2017, SME lending expanded at a rate of 12 per cent, and lending to the corporate sector as a whole also almost reached double-digit growth in annual terms. In 2017 Q1, SME lending was still strongly supported by the Funding for Growth Scheme, but even after its phasing out there was no decline in this segment.
**Figure 2:** The growth rate of corporate and SME lending

Source: Compiled by the author based on MNB data

**Figure 3** visualises the amount of new corporate loans in the credit institution sector. By 2013 CHF loans had been fully abolished. EUR loans still very popular in Q2 2010 plunged by Q1 2011 and after fluctuations between Q2 2011 and Q1 2017 started to bounce back. HUF loans under the Scheme reached their all-time high in Q3 2013, underpinning a high demand on behalf of corporate customers and utilising the diversified objectives of the 1\textsuperscript{st} phase. The longer 2\textsuperscript{nd} phase and a change in the objectives show fluctuations, although in Q4 2015 FGS-HUF loans exceeded other HUF loan schemes. From Q1 2016 until its phasing out FGS-HUF loans showed a steady decline. The Scheme offered EUR loans only in the 3\textsuperscript{rd} phase, their value was only 25% lower than that of FGS-HUF loans.

**Figure 3:** New corporate loans in the credit institution sector bn HUF

Source: Compiled by the author based on MNB data
The FGS may also be dealt with regards to changes in the credit conditions. Within credit conditions, a distinction should be made between price and non-price conditions. Non-price conditions influence changes in the clientele considered creditworthy by banks and the conditions of access to credit. Price conditions, in turn, show the price of borrowing for creditworthy customers. Credit conditions also reflect economic outlook, risk tolerance, industry-specific outlook, capital position, liquidity position and competition. In the post-crisis period the whole corporate sector faced the tightening of the credit conditions. For the sector loosening started in 2013 and keeps going on since then.

In 2014 on the whole there was no substantial change in credit conditions; 29 per cent of respondent banks eased conditions only in respect of the maximum maturity [MNB, 2014b]. In 2015 the favourable liquidity and capital position of the banks, as well as, a change in risk tolerance also contributed to easing. Improvement in economic prospects was also mentioned as a factor contributing to easing. In terms of standards, banks primarily eased their collateralisation requirements, the maximum maturity and the maximum amount of the loans and credit lines [MNB, 2015].

Since 2015 credit conditions have been continuously easing as a result of increasing competition between banks. In some of the latest lending surveys [MNB, 2017b] banks reported easing in credit conditions in all corporate size categories. This easing was primarily justified by the competition and favourable economic prospects and mainly reflected by a decline in interest rate spreads. Based on banks’ observation, the quality of the corporate loan portfolio generally improved both in terms of the default rate and the loss given default, which may have contributed to the perception of the economic outlook. (Figure 4)

![Figure 4: Changes in credit conditions in the corporate sub-segments](image)

Source: Compiled by the author based on MNB data

Since Q1 2012 Forint interest rates on corporate loans started a steady decline. From 10.5% the interest rate fell to 4.9% in Q4 2014. After a short setback in Q1 2015 this decrease further continued. By Q3 2017 the interest rate fell to 3.37% and stood only slightly above the interest rate spread. The gap between the Forint interest rate and the interest rate margin gradually narrowed. The 3.37% interest rate was only slightly above the 2.5% interest rate of the FGS, thus it was time for the central bank to switch over to the Market-based Lending Scheme (MLS) (Figure 5).
In 2017, the central bank facilitated lending with positive incentives through the MLS in an indirect manner. In 2017 participating banks overfulfilled their SME lending commitment. According to predictions corporate lending may continue to expand in the future. Besides the buoyant economic growth and the low reference rate this will further be supported by the lending commitments of banks within the Market-based Lending Scheme.

**The short-term effects of the Funding for Growth Scheme**

The impact on growth of the Funding for Growth Scheme (FGS) depends significantly on the borrowing characteristics of the companies participating in the scheme. Taking into account the effect mechanisms of the FGS, the following borrowers may be distinguished in the non-financial corporate sector: (1) Mostly credit-constrained companies which used the Scheme for working capital financing. Even if they did not generate new investment directly, they could also increase their efficiency and retain their positions on the market. The FGS may have contributed to their financial sustainability; as a result they may have new investments as a second-round effect over the long run.

(2) Companies which took out investment loans could implement their investment objectives directly, which they would not have been able to do without the Scheme’s favourable conditions. Therefore, their impact on growth and employment can directly be measured over the short run, as well.

According to model estimations\(^3\), the FGS has an effect on both credit supply and credit demand. On the demand side, the predictable and favourable funding scheme enabled the implementation of more investment than lending under market conditions. On the credit supply side, in turn, a wider range of companies could have access to loans. Therefore the Scheme may exert a stronger impact because it also targeted companies which otherwise would have had limited access to credit.

---

\(^3\) See more MNB [2018], p. 19
During the whole implementation period of the Scheme (from June 2013 until March 2017) approximately 40,000 SMEs were granted favourable loans in the total value of HUF 2,800 billion. As a result, from its decline SME lending was brought to a growth path contributing to the country’s economic growth by 2 per cent from 2013 to 2016 and increasing employment by 20,000 people. Due to the preferential credit conditions, enterprises were able to implement deferred investments, reduce their exchange rate risk and improve their financial position [Fábián – Pulai, 2018].

Conclusions
In the post-crisis period the launch of the FGS constituting a part of the monetary policy instruments managed to hinder the negative spiral in Hungary by reducing the interest costs to reasonable levels. As a result, decline in corporate lending came to an end. The new credit conditions increased the willingness of companies to invest, and led to the improvement of financial intermediation. The data collected in the initial phase of the Market-based Lending Scheme provides evidence for an additional growing demand for working capital loans indicating the positive spill-over effect of the FGS. It is also worth noting that some indirect effects may develop even years after the closing of the Scheme, thus further data are required for their quantification.

References


