Hungary Policy Brief

APRIL 2016

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Finance

IMPROVING SMES' ACCESS TO FINANCE

- Credit to small and medium sized enterprises (SMEs) declined more in Hungary than in most other countries since 2008, and credit conditions remain comparatively tight, especially for small businesses, firms with a higher risk-return profile and firms seeking long-term loans.
- An extensive loan subsidy scheme by the government has stabilised SME lending, but involves drawbacks such as displacing private activities, misallocation of capital and fiscal costs.
- The banking sector is struggling with a legacy of non-performing loans, a high tax burden and an unfavourable operating environment.

What's the issue?

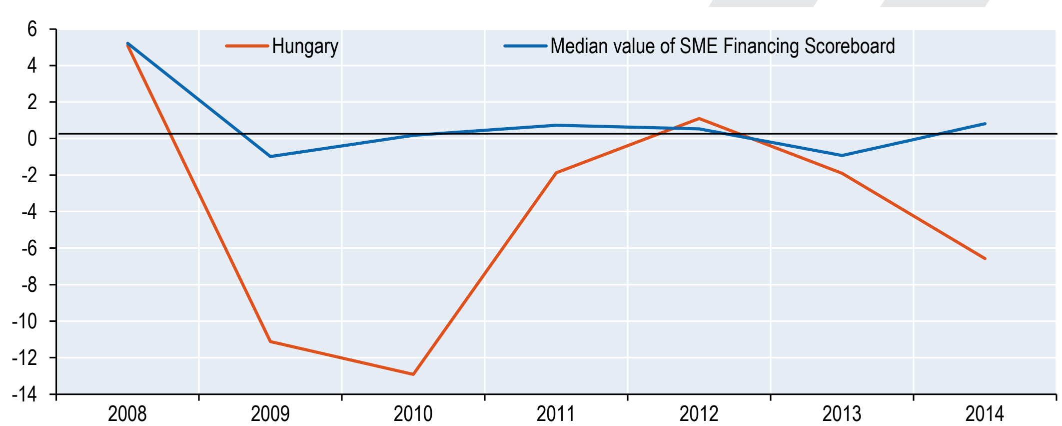
The financial crisis has had a pronounced impact on SME lending in Hungary, which, in real terms, declined by almost 30% between 2008 and 2014 (see Figure). Credit conditions also tightened significantly after the financial crisis and remained restrictive in 2015, with the effects mostly felt by small enterprises and by firms seeking long-term finance. The interest rate spread between loans charged to SMEs and large enterprises stood at 2.7 percentage points in 2014, up from 1 percentage point in 2008 and much higher than in most other OECD countries, reflecting increased risk aversion by Hungarian financial institutions.

The central bank initiated the Funding for Growth Scheme (FGS) in 2013, under which interest-free refinancing loans are provided to credit institutions for on-lending to SMEs at a capped interest rate. Between its inception and the end of 2015, 31 000 enterprises obtained financing through this scheme for a total amount of HUF 2 126 billion (5.8% of GDP). The FGS has contributed significantly to the stabilisation of SME credit since 2013, but is now gradually phased out. The newly introduced 3-year interest-rate swap conditional on lending activity is a positive step that should help attenuate the effects of phasing out the FGS. These swaps are worth up to HUF 1 trillion and will be available over a limited period in 2016 for banks, which will have to increase their stock of SME loans if they want to access this new swap facility.

Lending outside the FGS is still declining strongly, however, resulting from persistent weaknesses in

Credit to SMEs contracted more in Hungary than in most other countries after the financial crisis

Year-on-year percentage change of the outstanding stock of SME loans in real terms



Note: The 2012 increase in SME lending can be attributed to a reclassification of some large enterprises as SMEs.
Source: OECD (2016), Financing SMEs and Entrepreneurs 2016: An OECD Scoreboard, OECD Publishing, forthcoming.

Hungary's banking sector, which has not regained adequate profitability since the outbreak of the financial crisis. Since 2010, a tax for bank assets is levied on banks operating in Hungary. This tax burden in combination with an unpredictable operating environment and tight regulation has reduced the profitability of lending and this is having a particularly strong impact on SMEs. The banking sector is also grappling with a high proportion of non-performing loans. In 2014, 20.7% of the outstanding SME loan portfolio was non-performing, up from 5.4% in 2009 and much higher than the proportion of non-performing loans in overall corporate lending. Hungarian banks are deleveraging as a consequence and are taking a very cautious and risk-averse stance, with disproportionate effects for small businesses.

Venture capital investments in Hungary rose from HUF 700 million in 2009 to HUF 18.8 billion in 2014, offering equity financing for innovative, fast-growing start-ups. However, the venture capital market is largely dependent on support from the European Commission and European Investment Fund, in particular the "JEREMIE" programme. The planned launch of a growth equity market for SMEs at the Budapest Stock Exchange has the potential to facilitate small issuers' access to risk capital and complement bank lending. Improved incentives for participants should enable a healthy market ecosystem that can support SMEs on and after their listing, while stimulating venture capital activity by providing exit opportunities.

Why is this important for Hungary?

The Hungarian economy has broadly recovered from the financial crisis, with GDP surpassing 2007 levels at the beginning of 2015 and growth expected to surpass the EU average in the next few years. However, bank lending remains subdued, especially to SMEs. This may put the sustainability and vigour of the recovery at risk, especially given the importance of SMEs in the Hungarian economy: they employ more than 70% of its workforce and contribute to more than half of its value added.

What should policy makers do?

- Given the importance of the FGS to SME lending volumes and conditions, carefully assess the impact of the gradual phase out of the scheme and readjust if necessary.
- Advance the launch of a growth equity market for SMEs at the Budapest Stock Exchange, supported by proportionate listing and compliance requirements.
- Strengthen the health of the banking sector by carrying out proposed plans to reduce taxes on banking and considering further cuts to bring the tax burden closer to the EU average.
- Review regulatory requirements to avoid unduly discouraging bank lending to SMEs, while ensuring financial sector stability.
- Tackle the high volume of non-performing loans, in particular by facilitating NPL resolution.
- Use high quality securitisation of SME loans by banks (under the EU framework for simple, transparent and standardised securitisation) to free up credit capacity in the banks' balance sheets and promote further on-lending to SMEs.
- Move forward with the proposed introduction of the proposed corporate credit reporting system and ensure that this system contains granular and standardised data and is made available to a wide range of market constituencies.
- Work to implement the G20/OECD High-level Principles on SME Financing.
- Promote financial education amongst small business owners to address the lack of awareness of alternative financing instruments and skills required to access these.

Further reading

OECD (2016), *Financing SMEs and Entrepreneurs 2016: An OECD Scoreboard*, OECD Publishing , forthcoming.

Nassr, I.K. and G. Wehinger (2016), "Opportunities and limitations of public equity markets for SMEs", OECD Journal: Financial Market Trends, Vol. 2015/1. http://dx.doi.org/10.1787/fmt-2015-5jrs051fvnjk

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Nassr, I.K. and G. Wehinger (2015), "Unlocking SME finance through market-based debt: Securitisation, private placements and bonds", OECD Journal: Financial Market Trends, Vol. 2014/2. http://dx.doi.org/10.1787/fmt-2014-5js3bg1g53ln