

The FHB House Price Index; assessing the first half of 2012

The FHB House Price Index

A slight increase in the second quarter of 2012

According to the latest processed figures of the F HB House Price Index, house prices started to increase slightly in Hungary compared to the previous quarter. Chart 1 shows the index values between 1998 and 2012 Q2 in relation to the value in 2000 while Chart 2 indicates the annual nominal changes in the FHB House Price Index and deflated by CPI.

After a 5.1% decrease in 2010, house prices declined by 1.9% in 2011, in real terms by 5.5%. In the second half of 2011 prices dropped by a further 1.6% compared to the first half of the year and this tendency continued in the first quarter of 2012. Based on the so far acquired figures, however, a **slight increase started in Q2 of 2012, where house prices grew by 0.8% in nominal terms compared to the previous quarter. Compared to the same period in 2011, the same figures mean stagnation (a moderate, 0.5% drop was recorded).**

2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2
172,4	170,6	170,8	170,2	171,5

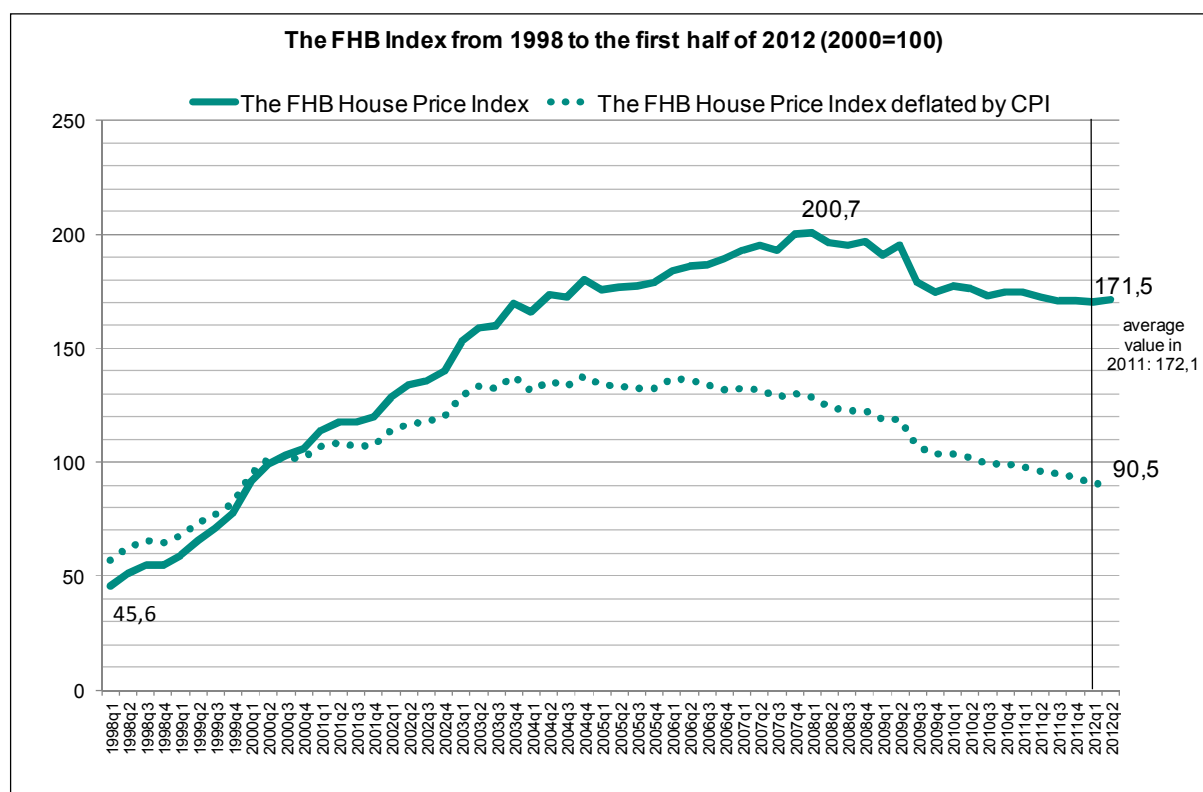


Chart 1: the FHB House Price Index (Source: F HB)

Based on the above figures, we can state that the pace of the decrease in house prices slowed down between 2009 and 2011. **However, only weak signs of the turn at the low point can be seen as yet and very dispersedly.** This positive tendency is further weakened by the fact that all this is happening parallel with the lowest turnover recorded in the housing market over the last 10 years and the "symptoms" of this crisis can still be felt in both the supply and demand signs, therefore, **we maintain our previous forecast, according to**

which even a moderate change in the turnover is to be expected only in the second half of 2013 as well as the fact that the increase in the turnover will not generate an equal rise in prices in the medium-term.

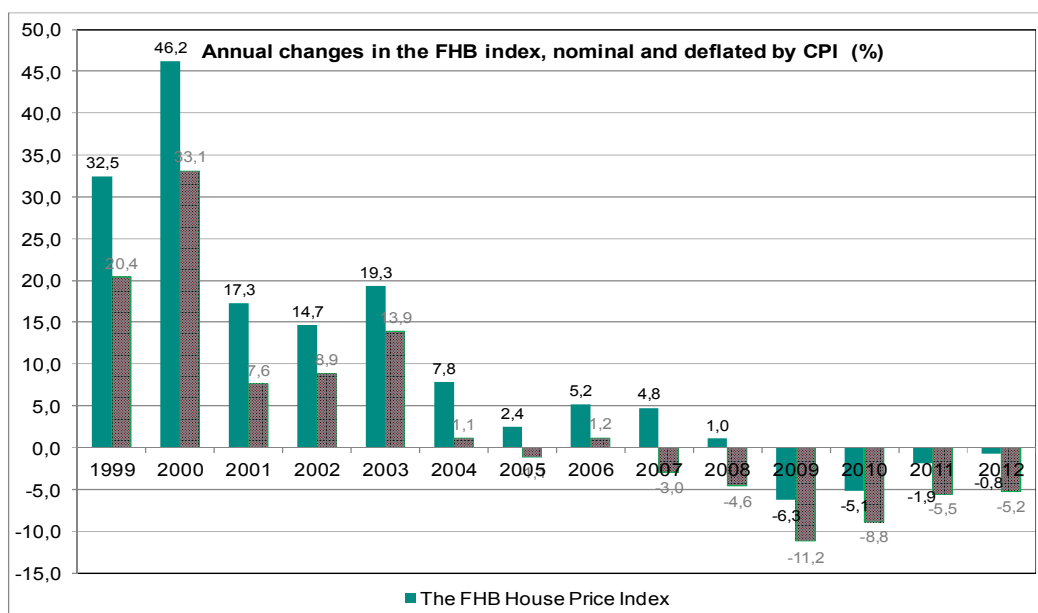


Chart 2: annual changes of the F HB House Price Index, nominal and deflated by CPI (1999 – 2012, in % of the previous year. Source: FHB)

Dispersedly encouraging but still feeble signs

Changes in the FHB House Price Index on short base, that is to say compared to the previous quarter can be seen in *Chart 3*. Looking at the latest quarterly figures, an encouraging change is visible considering the fact that we are still in a period of depression. The level of fluctuation is smaller and the growth measured at the latest data point, in 2012 Q2, exceeds the drop in 2012 Q1. According to the chart, **a gentle and slow-paced upward sloping curve will possibly put an end to the "valley shaped" downward trend that started in 2006.**

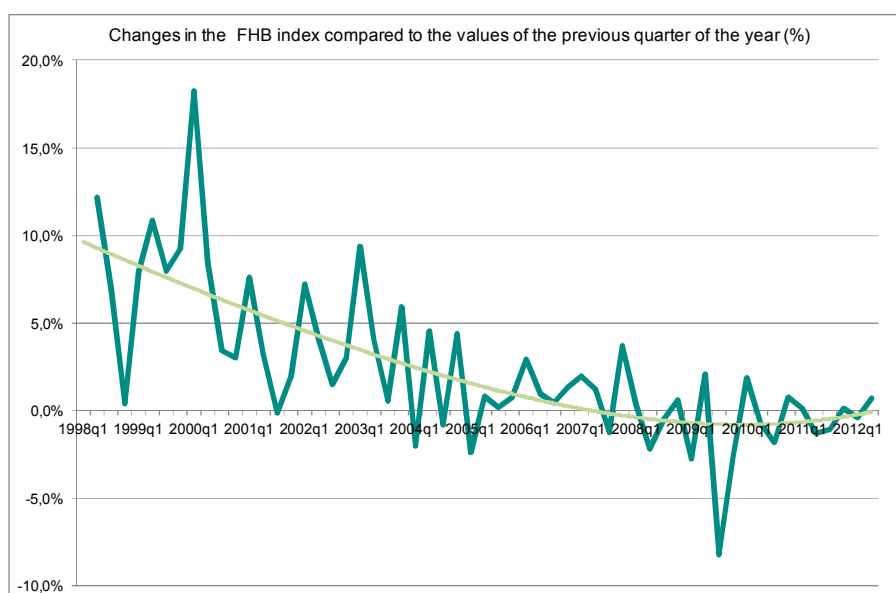


Chart 3: Changes in the FHB House Price Index compared to the value recorded in the previous quarter (1998 – 2012, %, Source: FHB)

The changes in the house price index of the capital city and that of other cities and towns show encouraging signs at regional level (Chart 4). In the case of the capital city and other cities and towns, the decline after the depression was followed by a slow stabilization and in 2012 Q2 a moderate increase can be seen (in the capital city 1.6%, in other cities and towns 3.9%). The rise in both cases exceeds the rate of the moderate decrease seen in 2012 Q1.

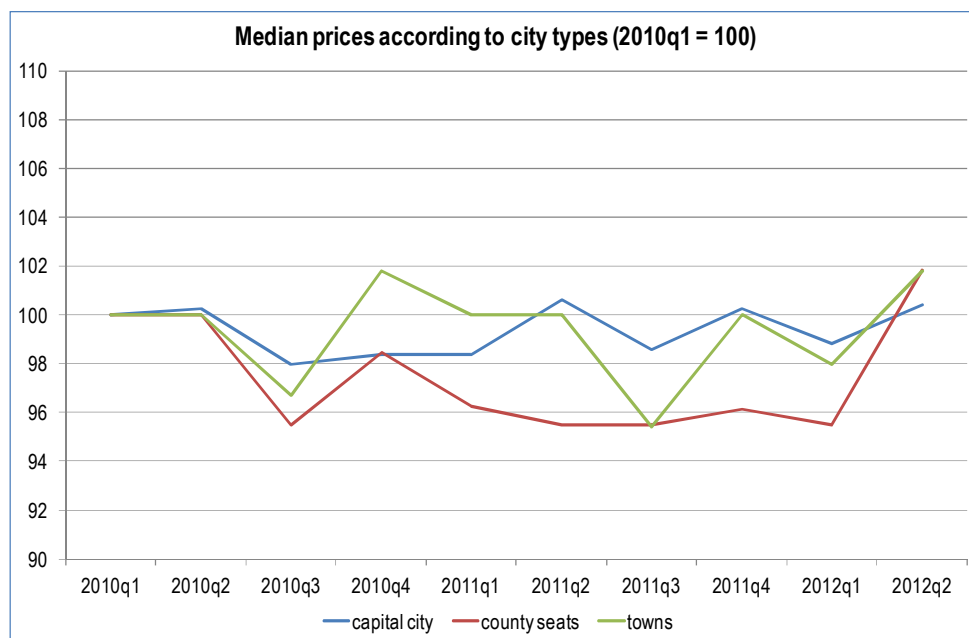


Chart 4: Changes in the house price index of the capital city and other cities and towns compared to 2010 Q1 (Source: FHB)

This change in the prices is in accordance with our previous forecast predicting that the turn in the housing market - regarding the prices then the turnover - will first occur in the capital and the highly developed county seats, then in the smaller towns and finally the process will reach the larger and smaller villages.

The supply-side

The construction of housing units in 2012 - the end of the dramatic decline on the supply-side

Although the number of housing units built dropped compared to the same period of the previous year – 5585 new housing units were completed in Hungary in the first half of last year, in 2012 this number has been 4463 so far (Chart 5) – some promising signs can be seen here as well.

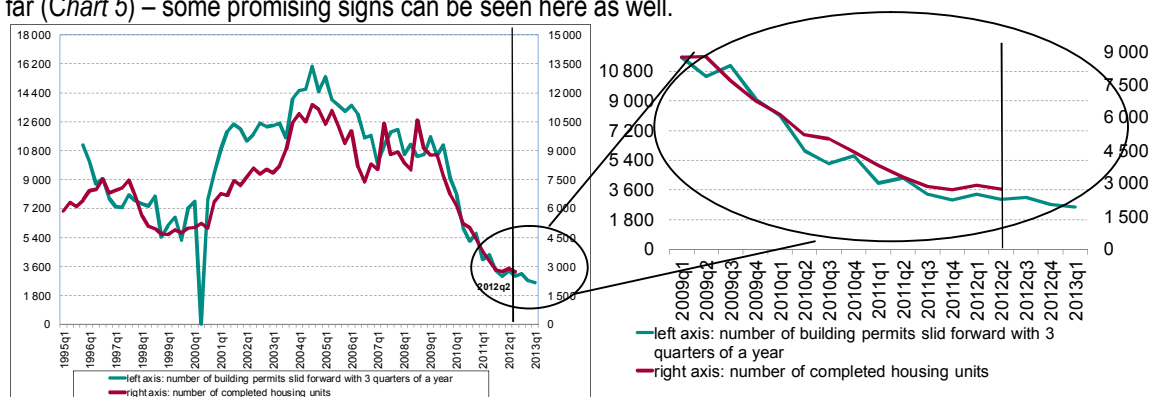
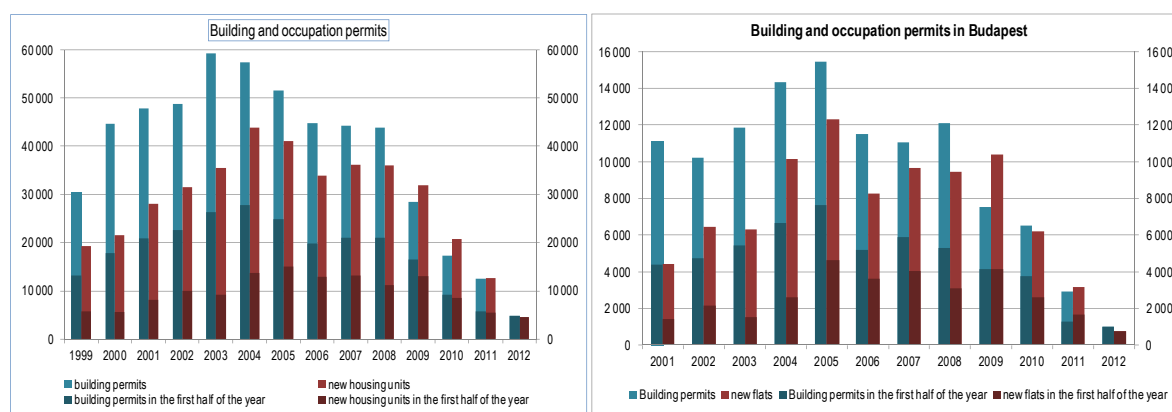


Chart 5: Forecast on the number of housing units built (Source: Hungarian Central Statistical Office (KSH), seasonally adjusted figures)

The relationship between building and occupation permits is shown in *Charts 6. a and b* on a national scale and in Budapest. It is quite visible that the number of both building and occupation permits is still rather low. **A significant turn in 2012, however, that for the first time since 2008 the number of building permits has exceeded the number of occupation permits. This turn has taken place in Budapest as well.**

This fact confirms that we have reached the low point of the supply-side in the capital, however, there is no chance of a turn either on the market of newly built housing units before the end of 2013 and the beginning of 2014 but presumably the number of newly built housing units will not drop in the next 12 months.

The autonomous (without any interference) supply on the market of newly built housing units has hit its low point, the effect of the upturn is rather fragile here as well, and as well as in the case of secondhand housing units, it will result in a sensible change mostly in the more developed cities/towns and in their agglomerations.



Charts 6 a and b: the number of building and occupation permits on a national scale and in Budapest (Source: Hungarian Central Statistical Office (KSH))

The examined indicators seem to be more favorable in the construction industry (*Chart 7*), the initial signs of growth in the sector's contract portfolio are visible. Although we do not possess detailed information we are of the opinion that **this increase could be explained with the infrastructural developments of the state financed from EU funds**, therefore, it would be too early to expect such a major turn in the volume of construction of housing units.

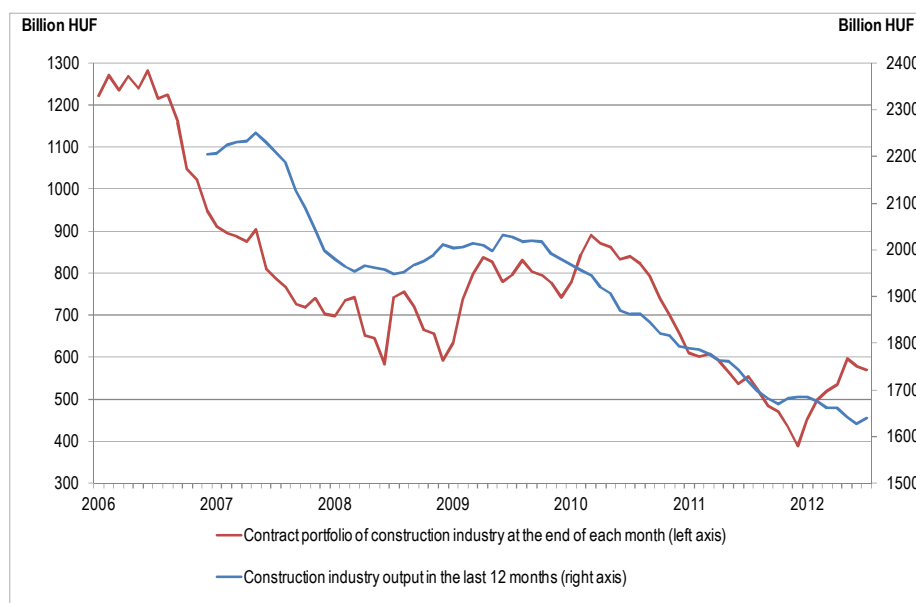


Chart 7: Construction industry output and contract portfolio (Source: Hungarian Central Statistical Office (KSH))

Prospects of lending after the early repayments at non-market rate

The total outstanding of residential mortgage loans continues to decline even after the early repayments at nonmarket rate

There is a very strong correlation between the net lending of residential mortgage loans and housing unit transactions as it is indicated in *Chart 8*. The market conditions are perfectly described by the fact that, on the one hand – **due to the recession** – the number of housing market transactions dropped significantly, and on the other hand that – **parallel with this** – the lending of residential mortgage loans decreased dramatically.

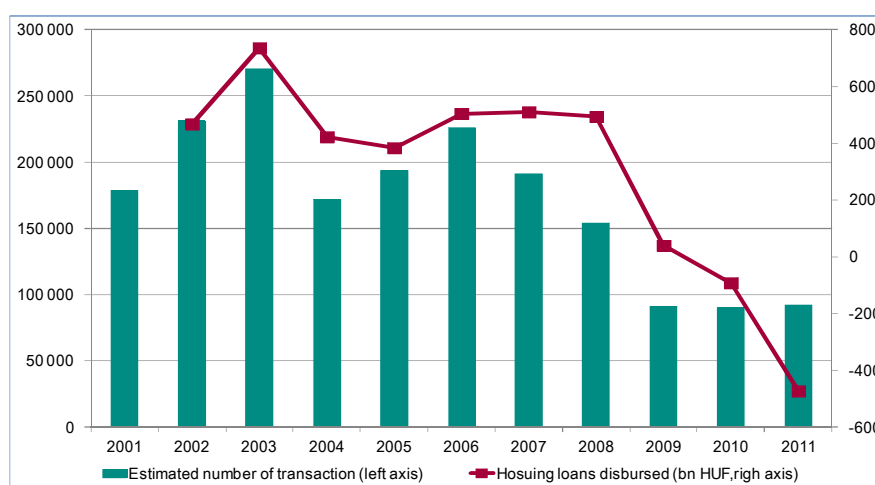


Chart 8: Estimated number of housing unit transactions and net lending of residential mortgage loans (Source: Hungarian Central Statistical Office (KSH) figures and FHB estimates)

Hungarian households have been net loan re-payers for years (*Chart 9*) and have remained loan re-payers even after the mass early repayments at non-market rate. Parallel with this – also influenced by the changes in the exchange rate of foreign currencies – the total outstanding of mortgage loans has been constantly decreasing.

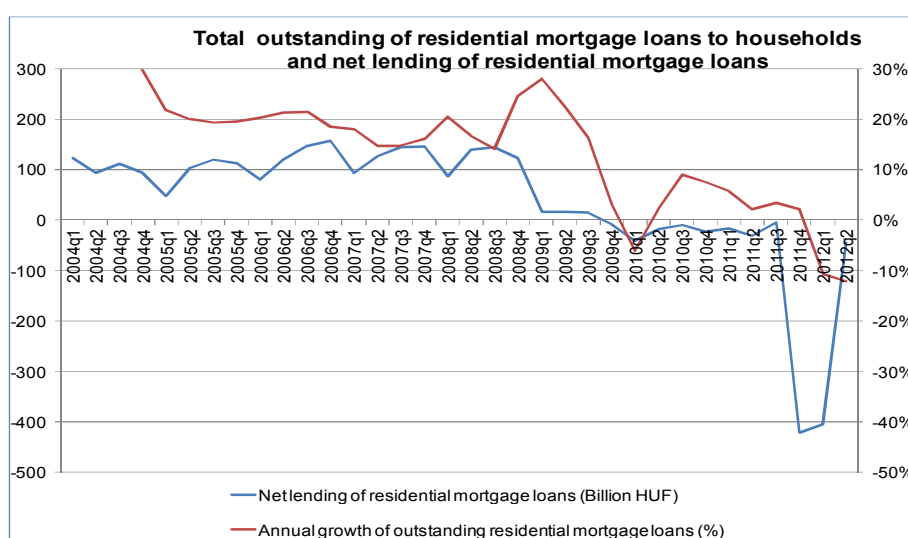


Chart 9: Total outstanding of residential mortgage loans to households and net lending of residential mortgage loans (source: Hungarian National Bank and FHB estimates)

Chart 10 illustrates the characteristics of certain types of residential mortgage loans to households. During the recession, due to the majority of market players exiting the market then followed by the prohibition, the dominance of Swiss franc loans came to an end but hardly any HUF loans were launched instead of them. **Financing the early repayments at non-market rate resulted in the growth of HUF mortgage loans in 2012.** According to the surveys of the Hungarian Financial Supervisory Authority (PSZÁF), nearly 23% of the early repayments were re-mortgaged by new HUF loans.

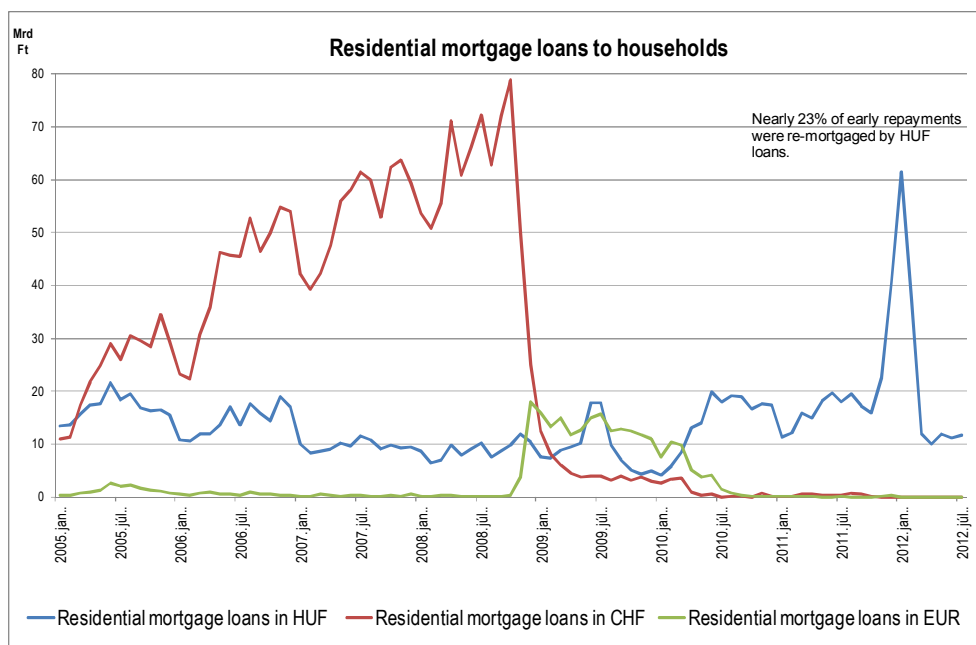


Chart 10: Residential mortgage loans to households (Source: figures of The Hungarian National Bank and FHB estimates)

The one-time effect is very well shown by the fact that the flow of new residential mortgage loans dropped back to a level even lower than before the early repayments at non-market rate commenced, in spite of the fact that according to the „Survey on Lending” conducted by the Hungarian National Bank, the willingness to provide residential mortgage loans has increased significantly this year (Chart 11)

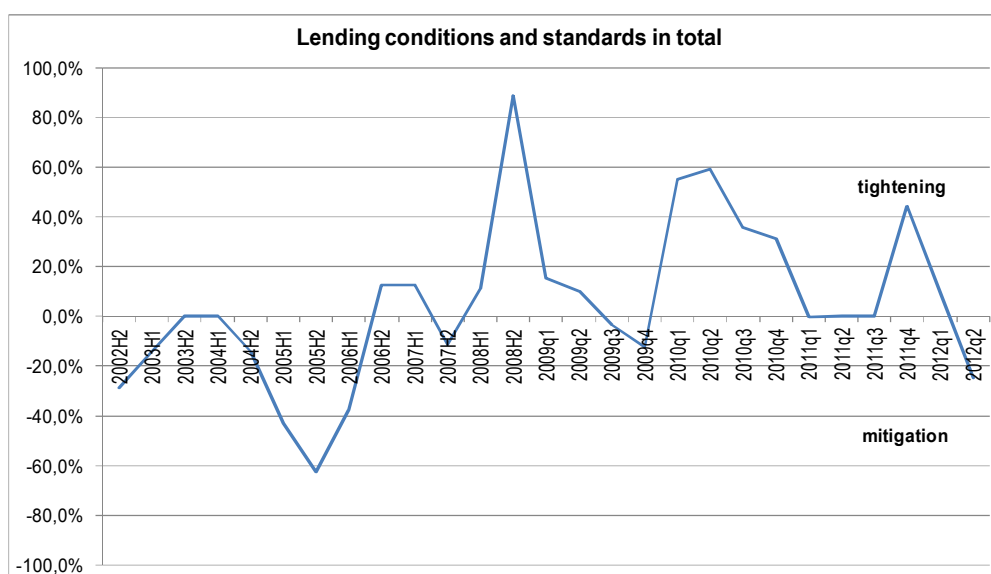


Chart 11: Changes in the lending conditions of residential mortgage loans according to the Survey on Lending conducted by the Hungarian National Bank (Source: Hungarian National Bank)

State interference should mean one of the pillars of recovery. *Chart 12* illustrates the importance of subsidizing loans, showing the proportion of obligors past due more than 90 days having subsidized (receiving interest subsidy), non-subsidized (HUF loans) and FX loans.

The situation of FX loan borrowers who have fallen into arrears with their repayment obligations due to the depression is clearly visible and so is the fact that obligors with subsidized loans manage to avoid falling behind with their payments more successfully.

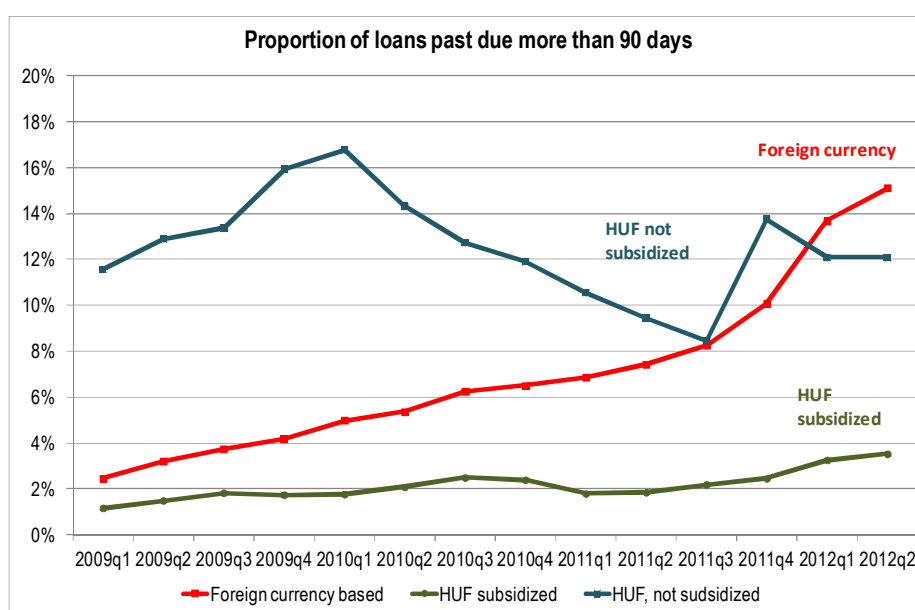


Chart 12: Proportion of loans past due more than 90 days (Source: Hungarian National Bank)

Although the causes of the decline in mortgage lending on the supply side seem to be receding, due to the high HUF interest rates during the period of depression and the income and expectations of households, it has become obvious that without a state interference the recovery for the housing market and the residential mortgage loan market might take a long time.

The subsidy scheme has revived

New housing subsidy scheme

Chart 13 illustrates the total outstanding of residential mortgage loans in Hungary broken down by subsidization and denomination. **It is clearly visible that in the early 2000s a substantial outstanding of subsidized HUF loans emerged. The conditions of lending becoming more rigorous diverted the demand for loans towards FX loans. After the depression, from July 2010, the draconian conditions of establishing mortgages connected to FX loans made FX mortgage loans disappear from the market.** One of the goals of the new housing subsidy scheme announced in 2011 and introduced in 2012 is to support HUF loans.

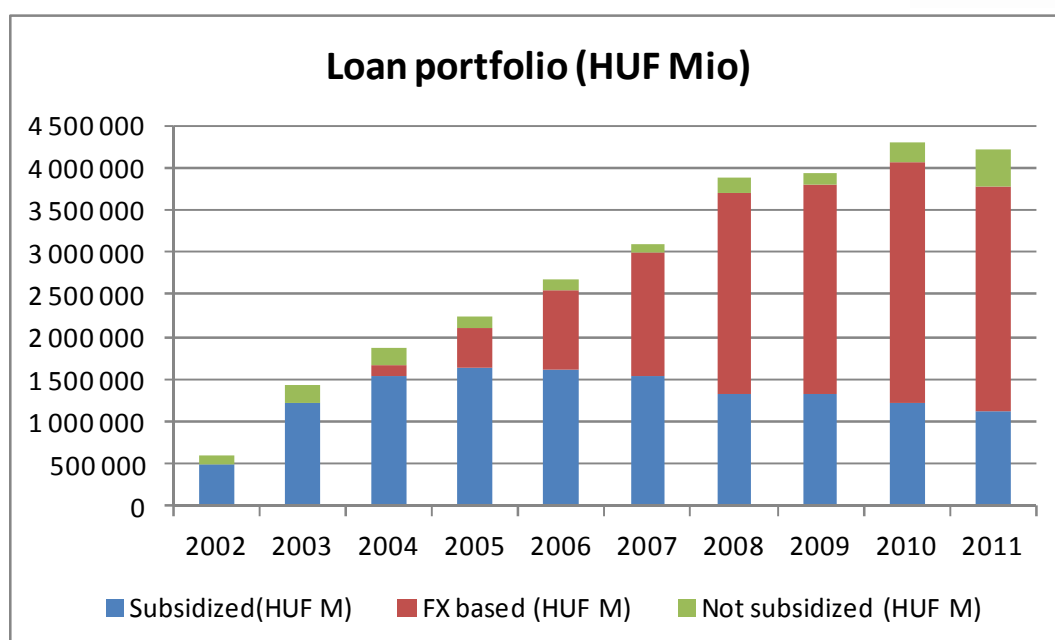


Chart 13: Total outstanding of mortgage loans (Source: Hungarian Central Statistical Office (KSH) figures and FHB estimates)

The government announced their new housing subsidy scheme in October 2011. The package contains two main measures: one of them referring to the so called „social housing subsidy” granted for building new housing units and another part regulating an interest rate subsidy system.

The social housing subsidy means a non-refundable lump-sum of 800,000-3,250,000 HUF, with subsequent settlement. Families bringing up at least two children are eligible for it (it can also be applied for for future born children under certain conditions) in respect of housing units in at least category „B” regarding their energy efficiency. The amount depends on the area of the housing unit, its energy efficiency and the number of raised or undertaken children. **One of the most important conditions to be eligible for it is that it can only be applied for to build a new housing unit or to purchase a newly-built housing unit.**

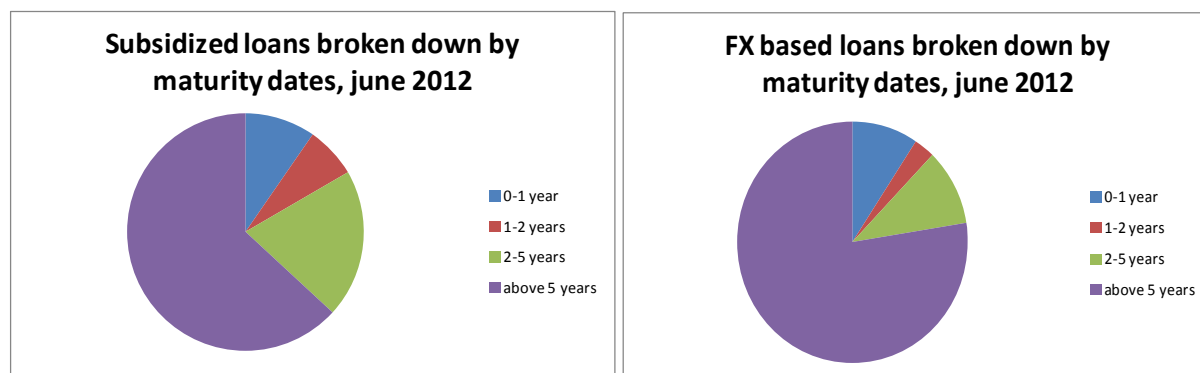
As opposed to the social housing subsidy, the **new interest subsidy system** can be used for loans raised for the purchase of second-hand housing units and their modernization/refurbishment. A further significant difference is that not only families are eligible for the interest rate subsidy, but the rate of subsidization (in the case of new housing units) depends on the number of raised children; the more children, the higher the subsidy. **The new system provides an interest rate subsidy during the first 5 years of the term of the loan in an annually decreasing manner. In the first year a maximum of 70%, whereas in the last year a maximum of 50% state subsidy can be applied for.**

The take-off of the new subsidy system was primarily hindered by the part of the regulatory measure regulating the operation of the banks: banks were only allowed to charge an interest rate that did not exceed the reference interest rate by more than 3 percentage points. **This condition was modified in July 2012** (the new interest rate cap was calculated by adding 3 percentage points to the 1.3 multiplication factor of the reference yield), **and as a result of this modification, several banks started to offer their related loan products.**

It is clear from the above facts that the **new housing subsidy scheme** introduced at the beginning of 2012 **actually started to work in the second half of 2012** (no modifications have been made concerning the social housing subsidy yet), therefore, **we do not yet possess sufficient information of its effects. Based on market estimates and preliminary inquiries, FHB is expecting at least a 50% growth in lending in 2013 (by this we mean real residential mortgage loans not related to early repayments at non-market rate or re-mortgage loans raised for early repayments and without building societies).**

The next pair of pie charts (*Charts 14. a and b*) show the maturity dates of outstanding subsidized HUF mortgage loans and FX mortgage loans in July 2012. It is quite visible that among the subsidized loans the proportion of loans with a maturity date of less than 5 years is significantly lower than with FX loans. However, among loans with a maturity date between 2-5 years, the proportion is higher in the subsidized outstanding loans. **These**

figures together indicate that subsidized loans are „going out” of the market. As a result of a successful interest rate subsidy system this process could change.



Charts 14 a and b: Subsidized mortgage loans and FX mortgage loans broken down by maturity date (Source: Hungarian Central Statistical Office (KSH) figures and FHB estimates)

FHB House Price Prognosis

A slow recovery of the macroeconomic environment is expected

Chart 15 shows the prospects of growth in the world, the European Union, Central-Eastern Europe and Hungary according to the forecast based on the IMF WEO database. **For Hungary, a lower growth is predicted than for the other Central-Eastern European countries** whereas the pace of growth is more or less the same as in the whole of the EU. Although such a pace of growth is not likely to lead to a convergence it is significantly better than over the last few years.

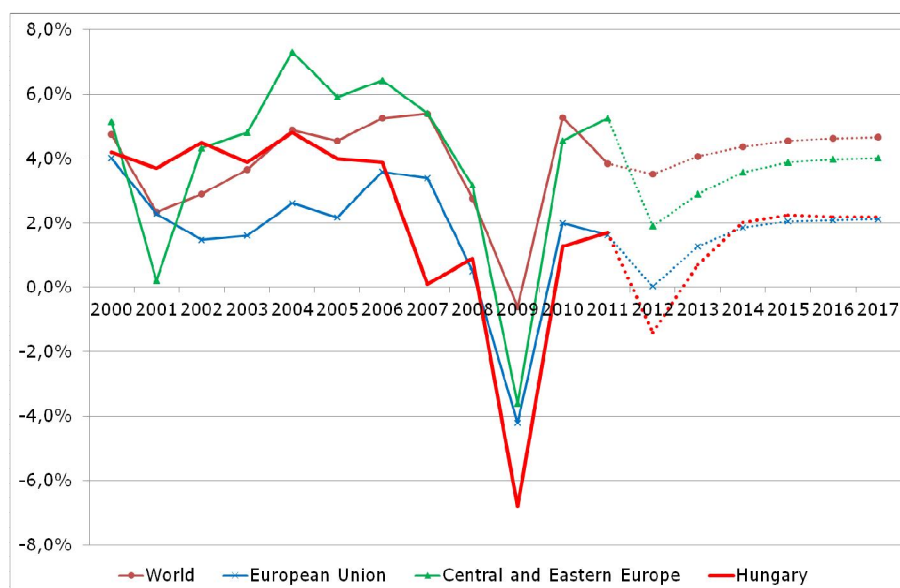


Chart 15: Prospect of growth in the world (Source: IMF WEO database and Reports on Inflation (September 2012) of the Hungarian National Bank)

In the light of the above facts, it is worth taking a closer look at the changes of certain macroeconomic indicators recently. Employment, which seriously affects the demand side, showed a 1% rise in 2011 (Chart 16). However, this growth is far from being significant: it is due to the newly implemented community service schemes and although there are some changes in the competitive sector, they cannot be considered to be permanent - yet. **Due to both its composition and the expectations of recovery, the positive change in the rate of employment might be fragile**, its effect on decisions over housing unit investments made by households cannot

be detected. The positive effects of the new labour law and government schemes aiming to facilitate employment are possibly delayed and **according to the major forecasters, this year, households' prospects for employment and income are worse than last year.**



Chart 16: Changes in the number of employed people (compared to the same quarter of the previous year, in %, source: Hungarian Central Statistical Office (KSH))

Chart 17 shows the changes in income, in nominal terms and deflated by CPI. **After the uneven growth in 2011, households' real income has been decreasing continuously in 2012. This change – together with the effect of the early repayments at non-market rate on sweeping away savings – mean a significant decline in demand concerning the housing market.**

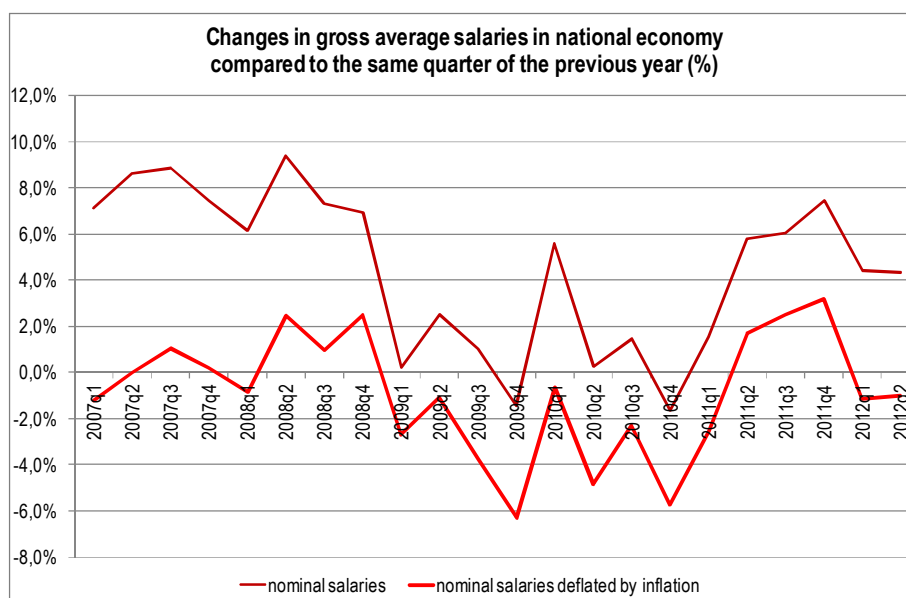


Chart 17: Changes in gross average salaries in national economy (compared to the same quarter of the previous year, in %, source: Hungarian Central Statistical Office (KSH))

In accordance with this, the macroeconomic prospects continuously deteriorated during the year. For 2012, the Hungarian National Bank is expecting an **economic downturn** and experts predict a **recovery-growth of less than 1% even for 2013** (Chart 18).

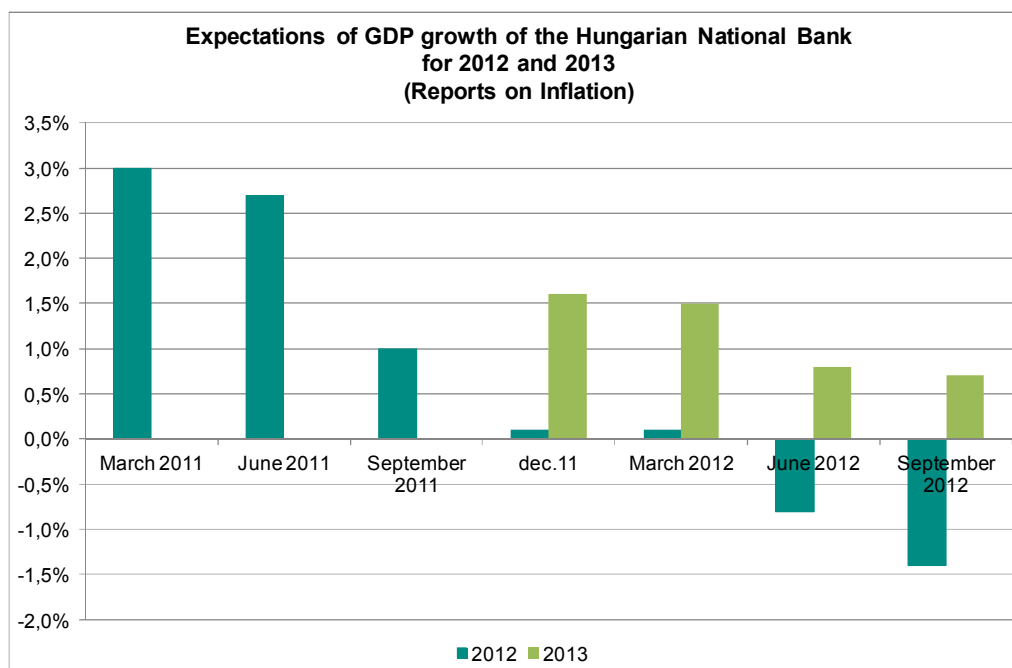


Chart 18: Changes in recovery prospects since the beginning of 2011 (GDP, compared to the previous year, source: Reports on Inflation of the Hungarian National Bank)

Prognosis for 2012: signs of an upturn might be visible dispersedly in the second half of the year

We intend to establish our prognosis on housing unit prices by considering the effects of all the factors examined so far. Among the aforementioned processes, **the processes of recovery still influence the demand side of the housing market negatively** and therefore the prices of housing units. **In the second half of this year, the effects of the new subsidy scheme on the housing market will most likely be rather limited and felt rather dispersedly.** The importance of this new system is expected to become much more significant by the second half of 2013 as it may attract new groups to the market; people looking for their first homes as well as households putting off their decision to move because of the high interest rates.. **This new channel, however, cannot fully compensate for the effects of the low income position of households and the further drop in their real income.** Again, we must emphasize that **the new subsidy system is vital to facilitate the housing market but on its own it is not sufficient; in the absence of a recovery-upturn, its effects might be limited.** The scarce nature of the supply side has become a reality in market segments with a high turnover, new housing units are only available in a limited number and housing units for sale as a result of early repayments at non-market rate have also exited the market. The scarce nature of the supply side might operate against the further drop in the prices.

As a result of these two effects, we predict that house prices will stop decreasing by the second half of the year as the consequence of the turn seen based on the figures of the second quarter. **Due to last year's peculiar price dynamics, for the whole of 2012 this process could mean stagnation or a very small, 0.5% decline.**

Prognosis for 2013: the conditions are given for a turn but the progress of the recovery will be crucial

In 2013, the processes that started in the second half of this year are expected to continue. An increase in lending willingness is visible with the conditions of lending loosening up as well as the quick appearance of the

new subsidy system. New products taking advantage of the interest subsidy are constantly appearing in the market of residential mortgage loans. This process is clearly influencing the demand side positively. **Demand might still be facilitated by the fact that house prices present a good opportunity for purchases.** However, any consolidation on the demand side can only be anticipated provided that income processes are stabilized. In accordance with our previous analyses, we are still convinced that **during the period of the depression, the macroeconomic factors are crucial.** After this year's slow recovery, analysts are predicting a more positive economic growth for next year, but the budgetary measures connected to the IMF-EU agreement may affect earnings through a number of channels. However, in the event that the agreement should be concluded, the macroeconomic environment may become more predictable and due to the middle term prospects becoming clearer, the population will be able and willing to undertake financial decisions with long-term obligations, that is to say, **the number of people making a decision to purchase housing units might increase.**

The low point of the construction of new housing units still presents a strong constraint on the supply side of housing units, which means that it is the base pillar of the changes in house prices. The quota-regulated forced sales point to a direction of growth, however, it seems that these transactions influence the direction of the whole of the market to a limited extent. Therefore, we still consider the constraint on the supply side as rather effective.

As a result of the ongoing processes both on the supply and demand sides, **with a rather low turnover we expect a very small rise in house prices not exceeding 1%.**

Our services connected to the FHB Index

The FHB House Price Index is published quarterly. Before its introduction, no other product of this kind was available in the Hungarian market. It is distinctive in terms of the measured time intervals and the quality of the underlying data, as well as its methodological foundations, which conform to international expectations. Since the introduction of the FHB Index in 2009, MNB (the Hungarian National Bank) and RICS (The Royal Institute of Chartered Surveyors) refer to it as a featured housing market indicator.

Updates to the FHB House Price Prognosis are published regularly.

The methodology behind the model rests on three pillars:

- I. On the basis of international and local experience, we have identified relations between selected Hungarian macroeconomic indicators, money-market and credit market indices, transactional data of the housing market and housing prices. (We base our view of the development of the macroeconomic and financial environment primarily on the projections of the Hungarian National Bank.) The FHB Banking Group has been one of the major actors among Hungarian housing market financiers for over a decade. Our operations cover the entire country, and we have access to information from the most significant real estate appraisers, which is complemented by FHB Real Estate Ltd's own professional experience. Our forecasts, therefore, include processed and verified local assessments as well..
- II. With respect to the economic crisis, we do not disregard empirical facts gained from analyses of similar depressions that have affected real estate prices so far. We have, therefore, included the international experience obtained from similar crises in our model.

Our database, which covers the entire country and the methodological development of the FHB Index make FHB able to provide help to the financial sector to fulfill the collateral re-valuation obligations under Basel II (Government Decree No 196/2007 on the Management of Credit Risk and the Calculation of Credit Risk Capital Requirement). We are proud that our service has already been ordered by a number of Hungarian banks, subsidiaries of large international financial institutions. The banks will also need to comply with the strict regulations in the future, it is, therefore, useful to apply a procedure that conforms to international standards and can also be supported by documented methodology if required by authorities. For the implementation of the modern, internal valuation methodology, it is preferable to use a model that is based on transactional data and documented methodology whereby efficient and mass re-valuation becomes possible. By using this model, credit risk capital requirement can be reduced substantially, and excess capital can thus be freed. FHB Jelzálogbank Nyrt. has been using the real estate monitoring procedure – which also meets the requirements of the modern, internal valuation methodology – since 2008.

FHB also undertakes the preparation of unique research products meeting individual needs. In these, we offer local information on apartments and lots, more detailed explanations on the extent and dynamics of our prognosis as well as the analysis of the risks surrounding the realization of the trends forecast

We are pleased to give customized offers and to respond to any inquiries.

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