Global Capital

HUNGARY IN THE CAPITAL MARKETS

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The Government of Hungary has been committed to an economic policy that has been promoting the success of enterprises on domestic and foreign markets.

Our achievements in recent years speak for themselves: GDP growth has been robust and above the EU average in the past almost 10 quarters — around 3% — and the structure of growth has become balanced and sustainable.

Labour market trends have signalled a positive U-turn. At the beginning of 2016, the number of economically active people was up by 550,000 in Hungary, a 26-year record high, in comparison to the time when the new government took office in 2010. And even more importantly, two-thirds of this increase was registered within the domestic private sector. With the development of our vocational education system, we are readying ourselves for future challenges already. We expect that the overhaul of the system will lead to a higher number of employees with adequate, modern production skills.

The prudent and successful fiscal policy of recent years and the new attitude in government debt management have resulted in a strong external borrowing position of the country, while our exposure to external risks has been significantly reduced.

Thanks to our achievements, Hungary has become an excellent investment destination in Central Europe. The fact that the proportion of reinvestment by foreign companies active in Hungary is quite high proves this assumption. Besides production capacities, more and more foreign enterprises bring their research and development capacities to Hungary and for the year 2016 they have recently voiced their most optimistic expectations in years. Meanwhile, since the roundtable discussion organized by GlobalCapital, Fitch has upgraded Hungarian government bonds to investment grade. This shows that not only markets but also one of the “big three” has acknowledged Hungary’s economic achievements.

The Hungarian Government continues to underpin the economy’s expansion through a pro-growth, investor-friendly economic policy, and this means that we have been trying to create the best business environment possible for Hungarian or Hungary-based enterprises.

Under the current favourable circumstances, we must focus on maintaining growth momentum; therefore we continue to support investment by domestic and foreign enterprises as well as the creation of jobs. Our re-industrialization policy aims to establish a competitive, crisis-proof production structure.

I am optimistic with regard to the future, as we can provide an attractive, stable operational and business background to foreign companies active in Hungary. In addition, there is a number of promising industrial development opportunities in the field of traditional and especially in the field of industrial sectors of high added value. The targeted industrial development policy of the Government has been helping to exploit these options in the fastest and most efficient manner possible.

I hope you will find the information provided by this roundtable discussion useful for your work and it will help enrich your knowledge of the Hungarian economy.

Mihály Varga
Minister of National Economy, Hungary
Hungary enjoys new found strength in local and international markets

“The Hungarian economy is performing very well and its vulnerability to external shocks has declined,” notes a recent IMF report. At the GlobalCapital Hungary roundtable, representatives from the public and private sector exchanged views on what recent indicators mean for the longer term performance of the economy, and on the country’s banking industry and capital market.

Participants in the roundtable, which was hosted by the Ministry of National Economy in Budapest in early May, were:

Mihaly Varga, Minister of National Economy, Republic of Hungary
Gyorgy Bacsa, SVP, group strategy and business development, MOL Group
Gyorgy Barcza, chief executive officer, Allamadossag Kezelő Központ (AKK) – Hungarian Government Debt Management Agency
Tomas Cerny, managing director, debt capital markets, CEE, Erste Group Bank AG
Klara Foldes, senior advisor, corporate banking department, Bank of China (Hungary)

Marton Kerekes, managing director, head of funding and liquidity, MFB Hungarian Development Bank
Gyorgy Kobor, deputy chief executive officer, chief financial officer, MVM Group
Daniel Palotai, executive director, chief economist, Central Bank of Hungary
Zoltan Urban, chief executive officer, Hungarian Export-Import Bank (Exim)
Laszlo Wolf, deputy chief executive officer, commercial banking division, OTP Bank
Phil Moore, Moderator, GlobalCapital

GlobalCapital: Minister Varga, perhaps you can open this roundtable by giving us an update on Hungary’s importance as an investment destination and on the recent performance of the Hungarian economy?

Mihaly Varga, Ministry of National Economy:
Thank you. Let me begin by saying that Hungary is an exceptionally good investment destination for at least four reasons. The pace of our economic growth has been stable and above the EU average for a couple of years. Labour market data shows significant and broad improvement, and through the development of our vocational education system we are readying ourselves for future challenges.

Our economic policy and the related regulatory background has been aimed at boosting growth and investment. Finally, the prudent and successful fiscal policy of recent years, a new attitude to state debt management and the forint conversion of forex household loans have bolstered the country’s external position and reduced our vulnerability to external shocks.

There is strong evidence that foreign investors active in Hungary appreciate these achievements. Re-investment volume is high, companies are relocating research and development capacities to Hungary, and existing investors are more optimistic about their prospects than they have been for many years.

In recent years the Hungarian economy has been placed upon a growth path that will ensure the country’s economic convergence with the rest of the EU. GDP growth has been stable, averaging around...
3% for the past 10 quarters, while the structure of this growth has become more balanced and sustainable. This means that expansion has not been coupled with external or internal imbalances. We have managed higher growth without incurring more debt, while the fiscal deficit has also been cut. Foreign trade has been another positive growth factor. Last year Hungary posted a surplus of €8.1bn, which is a huge increase compared to 2014.

Since 2010, when the new government came to office, 550,000 new jobs have been created, of which two-thirds are in the private sector. Over the same period, unemployment has fallen to an 11 year low of 6%. And in light of economic expectations, I can assure you that there is every chance that the number of people in employment will continue to grow from its current level, which is already at a 26 year high.

Moving on to our fiscal policy, I am convinced that this has also been instrumental in the positive U-turn in our real economic processes. Over the past couple of years, we have managed to keep the deficit of the central government budget below a sustainable level, or 3% of GDP.

In mid-2013, recognising that Hungary was capable of keeping the deficit below the 3% threshold, the European Commission ended the Excessive Deficit Procedure (EDP) against Hungary which had been in place for almost a decade.

By 2013, it had also become clear that the Hungarian model was working, and that it was possible to maintain a balanced budget together with economic growth rates that are dynamic by European standards. Furthermore, we have managed to fulfil the requirements of the EU and, at the same time, repay ahead of schedule the entire amount of the IMF loan which the previous government had taken out. The loan Hungary received from the European Commission has also been repaid.

We have successfully assumed the debt of local governments, but we have also defused an even larger time bomb and solved the issue of forex loans.

GlobalCapital: Do you expect this positive momentum to be maintained?

Varga, Ministry of National Economy: Yes. The Hungarian government’s commitment to a stable and predictable economic environment is reflected in next year’s budget bill, which we submitted to the National Assembly in the spring, well ahead of schedule. This projects GDP growth of 3.1% and a central government deficit-to-GDP ratio of 2.4% in 2017. This fiscal deficit target guarantees that the ratio of state debt as a percentage of GDP is set to decline further.

The reduction in the deficit and the positive economic trend reversal since 2013 have enabled the government to implement a highly successful debt reduction policy. The decline in Hungary’s general government debt-to-GDP ratio fell from 80.6% in 2010 to 75.3%, as a result of which Hungary had climbed to third in the EU's ranking of debt reductions at the end of 2015.

The composition of debt has also improved. Between 2011 and 2015, the share of forex debt was reduced from 52% to below 35% of the total, while the proportion of debt held by foreign investors fell from 64% to 48%.

These factors have significantly contributed to the reduction of the country’s exposure to forex risks and its vulnerability to external shocks, and this positive change is now priced in by international markets. The country’s risk premium dropped from above 600bp at the beginning of 2012 to some 160bp today.

The government has been boosting economic growth through a pro-growth, investor-friendly economic policy and a highly competitive tax regime, all of which makes us confident that Hungary’s economic growth will continue to be above the EU average.

In this favourable economic environment, our main task is to maintain growth momentum. Accordingly, the government continues to facilitate investment and job growth at both domestic and foreign enterprises. Through the implementation of our re-industrialisation policy, meanwhile, we aim to create a production structure that is competitive and crisis-proof.

To sum up, I am optimistic about the future of the economy, as Hungary continues to be a country that can ensure stable operations and provide an attractive business environment for foreign companies. At the same time, it offers massive industrial development options in the field of traditional industries, but even more so in the sphere of high added value production, while the government’s targeted industrial development policy helps fully exploit these opportunities within the shortest possible time.

GlobalCapital: Given the very positive picture you have painted of the Hungarian economy, is it a source of surprise and frustration that the ratings agencies seem so reluctant to upgrade the republic’s debt rating?

Varga, Ministry of National Economy: I am hopeful that following extensive discussions with the Hungarian government, the agencies will recognise that economic growth above the EU average, low and falling unemployment, declining public debt and a moderate state deficit are all good reasons to consider upgrading Hungary’s rating.

I have to repeat that we are on the right track, but I’m not sure that this will be enough for an upgrade, because I have the feeling that ratings aren’t always just about economics. They are sometimes also based on politics. I’m afraid that the next evaluation from the agencies will be based not just on economics but will also be a political decision.

If you compare the yield in the 10 year government bonds in Hungary and Poland, the yield is higher
in Hungary but there is a three-notch difference in the ratings of the two sovereigns. This suggests that investors’ decisions are not being greatly influenced by ratings agencies.

**GlobalCapital:** What sort of feedback is AKK getting from foreign investors about the economic outlook in Hungary?

**Gyorgy Barcza, AKK:** We meet bond investors throughout the world and their feedback suggests they agree about the long term positive outlook in Hungary. If you look at which part of the curve investors are most active in, it is clear that they favour longer dated bonds. The average maturity of foreign investors’ bond holdings in the local currency market is around five years. The large investors make their own internal ratings, and they believe that although short term ratings may not improve, over a three to five year horizon there will be a continuous improvement.

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**GlobalCapital:** Is it too early in the year to give an update on the progress AKK has made with the three key priorities in its funding programme in 2016?

**Barcza, AKK:** We’re generally in line with the objectives we published in our full year financing plan last December.

If anything, we have seen better demand than we expected in the retail market. We were positively surprised by the increased retail demand we saw last year, because in this very low interest rate environment retail-targeted products offering a premium are still very popular.

The financing plan was based on net supply of Hfr762bn, which is about 2.2% of GDP, and after the first four months of this year we are on target to reach this figure.

In terms of foreign currency debt, we originally planned to issue €1bn equivalent of FX issuance this year in euros, dollars or other currencies. We have already completed an RMB1bn transaction which was not large in terms of size. But the point of our RMB bond was not to issue in big size. Its main objective was to demonstrate our commitment to playing a role in the development of the RMB bond market over the next 10 years.

If demand continues to be strong in the retail market we won’t need to issue the €1bn in FX debt, but we will keep the option open. So I would describe issuance in FX as a possibility rather than a priority.

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**GlobalCapital:** I’d like to come back to the AKK’s landmark RMB bond issue later, but sticking with the macro story for the moment, what role has the central bank been playing in supporting continued economic growth? What role has monetary policy been playing, for example?

**Daniel Palotai, Central Bank of Hungary:** I’d broadly agree with what Minister Varga and Mr Barcza said about the macro-economy, but let me just highlight a few more important economic trends and developments.

Hungary’s main weaknesses during the crisis were stock vulnerabilities. Over the last five or six years I think we’ve done a great job in improving the flow indicators. But stock imbalances have been narrowing more slowly. Public debt has been declining but it is still larger than peer countries. External debt has come down from over 120% to 75% of GDP. So we’ve come a long way, but we still have significant stock imbalances to address.

One stock imbalance which has been resolved was foreign currency borrowing which has been converted. The Central Bank played a big role in providing over €8bn of its reserves for conversion at the market rate.

We have been targeting inflation since 2001. For most of this period there was little co-operation between the central bank and the government, regardless of which government or which central bank governor was in office. But in the last three years or so policies have been moving in the same direction and supporting each other.

It is very important to emphasise that we are a fully consistent and transparent irrespective of these changes.

In our case, these principles are based on reducing our total debt, decreasing the share of foreign currency in our debt, and encouraging increased participation of retail investors.

The reduction generated by this transparency in the overall risk profile of Hungary’s public is already being rewarded by markets through a lower cost of financing. Just two years ago, the average new issuance yield for total public debt was 3%. Last year it was 2.5%. In the first four months of 2016, it has fallen to 2%. This is the lowest cost of funding Hungary has achieved in the last 40 years, and it is well below the levels we were seeing 10 or 15 years ago when it reached between 5% and 8%.

People sometimes argue that issuing retail-targeted debt is expensive, but our experience has been that this has been a useful component in reducing total financing costs.
Daniel Palotai  
CENTRAL BANK OF HUNGARY

independent central bank, the primary objective of which is achieving and maintaining price stability. But we can also acknowledge that the government supports us in achieving this objective through its budgetary commitments which have helped to reduce risk premiums and increase the room for monetary policy and also by the management of administered prices and indirect taxes, which during the last decade have explained 90% of inflation in Hungary. In the last three years all these measures from the government have succeeded in creating price stability in Hungary. Headline CPI is now around 0%, and sometimes we have seen negative CPI over the last year mainly on the back of declining oil prices. But with economic growth of over 3% and wage growth of 5% we are definitely not in a deflationary environment.

Negative CPI doesn’t reflect the true inflation outlook, but is explained by tax cuts and low imported energy prices. Given that we are a net energy importer, Hungary is a beneficiary of low oil prices. So from a central bank point of view I can say that we are enjoying price stability even though we are undershooting our target for this year. But next year we expect to see inflation gradually increasing and thereafter moving up towards its 3% medium term target.

I believe the central bank has also been supportive of the government’s growth policies over the last couple of years. We recognised that a key bottleneck to growth in Hungary has been the shortage of affordable finance for SMEs. This challenge is not specific to Hungary but has been a problem for economies throughout Europe. Following the example of the Bank of England, we responded to this challenge by implementing our Funding for Growth scheme. This is a subsidised lending programme for SMEs providing loans via the Hungarian commercial banks of up to 10 years with a 0% interest rate. According to our estimates, this has made a very significant contribution to Hungary’s economic growth performance over the last three years. The SME sector is key in Hungary, given that around two thirds of employment comes from this sector.

I would also draw attention to our support for the management of public debt. Of course this is not a goal per se of the central bank, but we have a self-financing programme through which we help to reduce gross external national debt by allocating part of our excess reserves to the repayment of the government’s foreign currency debt. This helps to reduce the overall share of foreign currency debt and supports the financing activities of the debt management agency without jeopardising our primary mandate, which is price stability.

GlobalCapital: I’d like to come back to the AKK’s landmark RMB bond issue later, but sticking with the macro story for the moment, what role has the central bank been playing in supporting continued economic growth? What role has monetary policy been playing, for example?

Laszlo Wolf, OTP Bank: The Hungarian banking sector has become more and more active in financing SMEs in recent years. It’s true that the banks’ overall loan portfolio has declined in recent years but this has mainly been due to certain big items arising from the consolidation of state-owned companies. This is why the loan volume from borrowers like Hungarian Railways has decreased.

But at the same time, SME loan volumes among the Hungarian banks increased significantly. This year we are expecting loan growth in the SME sector of over 5%. The other banks may have lower growth than this but they will also see close to 5%.

I believe that the central bank’s loan programmes have played a major role in supporting the increase in lending to the SME sector, helping the Hungarian banking sector to promise loans of more than Hfr200bn to smaller companies. This may be too optimistic, but the important point is that banks are maximising their efforts to increase their support for the SME sector, which will help economic growth reach 2.5% in 2016 and a forecast 3% in 2017. This support for SMEs is especially important in an environment where EU funding this year will be lower than it was in the past.

GlobalCapital: What have been the latest trends in asset quality both in the SME market and in the broader Hungarian corporate sector?

Wolf, OTP Bank: There has been a lot of bad news about loan quality in Hungary. But it is important to recognise that the share of problematic loans has been declining in recent years, from about 17% to closer to 10%, depending on which part of the loan portfolio you’re looking at.

In the case of OTP, the provisioning level of these loans is now over 90%, so these so-called problematic loans are no longer so problematic. We hear that these loans are also well-provisioned at the other banks, so the issue of asset quality is not a limiting factor in terms of new loan growth.

Hungarian banks are also well capitalized, so there is no capital constraint to new lending. This may change if capital requirements become stricter across the EU, but as of today there is no problem with capital among the Hungarian banks.

GlobalCapital: Last November, the central bank announced the launch of a bad bank MARK – to help clean up banks’ balance sheets. Has this started to have an impact on the banking industry?

Palotai, Central Bank of Hungary: This is a very relevant topic. There has been a debt overhang in the commercial real estate segment of the banking sector for the last six years. Almost two years ago when we decided to address this issue it seemed to us that all market participants had adopted a wait and see strategy.
Banks had not made much progress in selling their non-performing assets because they were waiting for the economic situation to improve and for prices to recover. There were a very limited number of transactions taking place, but this seemed to be driven by cherry-picking from both sides. Banks only wanted to sell their worst assets and investors were only interested in buying the best.

Our contribution to the discussion about the NPL problem seems to have acted as a catalyst for the banks to address this issue. We recently organised a very well-attended forum in co-operation with the EBRD in Budapest, since when there has been very significant interest from the private sector in helping to clean up the banks’ portfolios.

We’ve had a detailed discussion with the European Commission aimed at establishing a public pricing methodology which would exclude any state aid for the banks. The position now is that there is a window open during which banks are in discussion with MARK about the transfer of non-performing loan portfolios. No transaction has yet taken place because the registration period is still open, and we will still have to see which banks are most open to the idea of avoiding cherry-picking by selling entire portfolios to MARK. The window was opened in March and will remain open until June, which is when we will be able to assess how successful the scheme has been.

Wolf, OTP: It’s worth pointing out that MARK is already managing the problematic portfolio of MKB, which was transferred to the Resolution Fund which asked MARK to manage the fund. The final impact of MARK will depend a lot on the pricing of the loan portfolios. If the pricing isn’t acceptable to the banks it will do nothing to improve their capital positions.

Palotai, Central Bank of Hungary: The pricing methodology is publicly available, so there is very little room for manoeuvre in terms of its formula.

Wolf, OTP: Our problematic loan portfolio is very highly provisioned, as it is at a number of other banks. Therefore it is crucial for us that we don’t incur any additional losses after we sell or transfer any of our loans. But OTP is one of the only banks in Hungary that has not made big losses on its real estate lending.

One final comment on the Hungarian banking sector.

We talked a lot about the problems in the banking industry over the last few years, and in 2016 we are expecting to see a return to profitability across the sector. This means the outlook for the financial sector and its role in helping the economy is positive.

But this profit will not come mainly from increased banking revenues, which will probably fall slightly. The improved profitability will be driven chiefly by significant cost cutting, lower risk costs and reduced bank taxes, all of which will combine to create a profitable industry in spite of reduced revenues in 2016-17, supporting an increase in bank lending.

GlobalCapital: Is there more scope for cost-cutting in the banking sector in 2016-17, or has this more or less run its course?

Wolf, OTP: This depends largely on the level of digitalisation achieved by the banks, which would allow them to close more branches and further streamline their processes.

GlobalCapital: Does the central bank echo this view? Does it see scope for increased profitability at the banks in 2016 and 2017?

Palotai, Central Bank of Hungary: Yes. Our forecasts assume a continued gradual recovery in the profitability of the banking sector. We don’t see profits returning to pre-crisis levels which were probably excessive, but we agree that healthier balance sheets will underpin more lending activities, which will support the longer term growth of the economy. More branches and further streamline their processes.

GlobalCapital: Do the Hungarian banks need more capital, as one of the ratings agencies has suggested?

Palotai, Central Bank of Hungary: No. Capital buffers are well above regulatory requirements. There are some differences from bank to bank, but overall the banking sector is very well capitalised and highly liquid.

GlobalCapital: Minister Varga and Mr Palotai both mentioned the contribution of trade and investment to Hungarian growth. How is Eximbank supporting rising volumes of both?

Zoltan Urban, Exim: As the minister said, our foreign trade surplus was above €8bn in 2015, which is the highest level for 30 years. This is directly related to the rising appetite among foreign direct as well as portfolio investors for opportunities in Hungary. By the end of last year, FDI had reached €48bn, which is about 79% of GDP, and shows that the confidence of long-term foreign investors is growing.

If you look at the breakdown of FDI into Hungary in recent years, there has been a very clear increase from US, German and Chinese investors. Last year, 67 new investors signed agreements to launch new projects, creating 13,000 new jobs in 2015 alone.

As a typical export credit agency, we support exports not only directly but also via the commercial banks. We are similar to the National Bank of Hungary in the sense that we refinance the commercial banks in the short, medium and very long term under OECD rules.
Roundtable: Hungary

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Last year we saw an increase in these facilities of 23%, and in 2016 we are forecasting a further increase in export financing of roughly 20%.

We are also seeing a growing number of SMEs within our portfolio. The SME sector accounted for about 84% of our clients at the end of 2015 and has been growing year by year. We’re also seeing a rising number of Hungarian SMEs increasing their exports to so-called exotic markets, and in some cases we are even seeing Hungarian companies competing with each other in countries such as Indonesia and China in sectors ranging from ICT to energy and water management.

We are also seeing Hungarian exporters entering the sub-Saharan African market. Because part of our job is to support Hungarian companies in non-traditional markets, we now have lending limits in 134 countries ranging from Latin America to Asia.

We have also introduced a number of innovations in recent years. For example, we have established funds to support exports with equity as well. We have set up two funds in co-operation with the IFC. One of these is designed to help Hungarian companies participate in international tenders, and the second is the IFC FIG Fund which supports financial institutions in areas like the sub-Saharan region. Parallel to that, together with the Ministry of the Economy, Hungary has invested in the EU-African Infrastructure Fund.

GlobalCapital: We heard earlier about AKK’s ground-breaking RMB transaction, and Mr Urban mentioned the importance of trading relations between China and Hungary. What is the outlook for Sino-Hungarian economic relations, and how important is the development of the Chinese capital market to Hungarian borrowers?

Klara Foldes, Bank of China (Hungary): China has a very clear strategy of RMB internationalisation in both the onshore and offshore markets. Since 2014, a number of new sovereign borrowers have come to the market such as the UK Treasury, and this year Hungary was the first sovereign to issue in the offshore Dim Sum market.

The transaction was also an important milestone for the market, because Hungary was the first issuer to come to the market for several months, and the first sovereign from continental Europe to access the Dim Sum market.

Another recent development in the RMB market is that Hungary has been designated as an RMB clearing centre. This is a major milestone in the internationalisation process which began in 2003, and today the RMB is the second most actively traded currency globally, the second most active in trade finance and the sixth in FX. Last year it was also added to the IMF’s Special Drawing Rights (SDR) basket. More than 50 central banks have opened accounts with the Bank of China Hong Kong to invest a portion of their reserves in RMB, and the Central Bank of Hungary is a member of this prestigious club.

Why was Budapest chosen as the regional hub for RMB clearing in CEE? First of all because of the quality of the relationship between China and Hungary. Second, because the Bank of China has been present in the Hungarian market for more than 15 years and has expanded very rapidly through cross-border transactions. We also have a presence in Prague and Vienna, so it was natural that Bank of China was appointed by PBOC as a regional clearing hub.

GlobalCapital: Given that the funding requirements of Hungarian borrowers are fairly modest, how likely is it that we will see other issuers accessing international capital markets in general, and the RMB market in particular?
There is indeed a fall in oil prices and low supply. The corporates have access to liquid and cheap bank finance. Overall, we believe issuance volumes in the region are low, which is a problem of supply across CEE capital markets. We saw a successful €750m 2023 issue in April from MOL, but apart from that there has been very little in terms of new supply from Hungary, hasn’t there?

Mrs Foldes said there are plenty of candidates for RMB issuance around this table. But more generally is there a problem of supply across CEE capital markets? We saw a successful €750m 2023 issue in April from MOL, but apart from that there has been very little in terms of new supply from Hungary, hasn’t there?

Mr Bacsa, MOL, provided a vivid example of this imbalance between supply and demand, generating orders of €2.5bn from more than 250 investors for its €750m benchmark in April. Perhaps you can say a few words about your investment plans and funding strategy, as well as on the feedback you had from investors about their demand for exposure to Hungary?

The fall in oil prices and low funding costs are benefiting the region a lot. Higher energy and funding costs would obviously be a disadvantage for a country like Hungary which lacks natural resources and is a net importer of energy, but which has a high level of production and marketing, and has easy access to overseas markets both to the East and the West.

A key advantage of Hungary is that we run a production-focused industry rather than one which is heavily natural resources-based. Another is that we have an efficient cost structure in terms of production and logistics costs.

At MOL we firmly believe that this region continues to enjoy relatively strong growth. At a time when global growth and funding costs are both very low, access to markets, economic stability and a low risk profile all give Hungary a competitive advantage.

This is something that investors recognise. There are no big growth opportunities without unacceptable risk profiles and the global economy is not providing high yields or big growth opportunities. So investors are looking to stable countries with low risk and moderate yields, such as Hungary.

To answer your question about our recent euro benchmark, we achieved close to record low yields and historic highs in terms of oversubscription. We recognised that with supply from the region so low, this would allow us to offer a slightly larger issue to investors without compromising on a historically low funding cost. Similarly attractive access to funding could be utilised by other issuers across the entire CEE region.

MOL Group is investing in production and marketing across the broader CEE region, where we believe we enjoy a number of competitive advantages compared to other parts of the world. We need to take advantage of this both at a corporate and at a government level.

There is indeed a shortage of supply out of CEE. The region is extremely stable from an economic perspective, and investors have rewarded this stability in terms of the premiums paid by issuers. Spreads have narrowed substantially in Hungary, and as we have heard earlier, the economic indicators would justify a rating upgrade.

Today, we live in a borrowers’ market rather than an investors’ market and investors would definitely welcome any issuance from CEE. However, most governments have done their job in terms of reducing their budget deficits, so there is a lack of sovereign supply. The corporates have access to liquid and cheap bank finance. Overall, we believe issuance volumes in 2016 will be very similar to what we saw in 2015.

Investors would very much like to see AKK returning to the euro market, and there would be very good demand for any new Hungarian sovereign or semi-sovereign issue. Any issues from Hungary’s top corporate universe would also be very well-placed. Investors recognise the tremendous progress that the government has made with its fiscal policy, and the government realises that the ball is now in the court of the private sector which now needs to be the driver of investment and growth.
Roundtable: Hungary

**Marton Kerekes, MFB:** Currently MFB’s activities are based around three major pillars. Probably the most important of these is funding the SME sector by channelling EU refundable financial assets into the economy.

MFB only has a pass-through role so this we are distributing an EU product which we expect to be popular in Hungary. In our role as a distributor, we provide the necessary risk management, operational support, IT and human resources, but the sales points will be commercial banks. We have now hired more than 400 commercial bank branches to place these products, and we will probably enlarge this distribution network by another 100 or 200 branches, which will give us a very large nationwide branch network. Unfortunately EU regulation means that this won’t cover central Hungary, which is regarded as being too developed as a region. So we will plan to develop a new product of our own for central Hungary.

The SME product is a pretty sizeable programme for 2016-2020 which is worth about €1.2bn, but it won’t require any additional funding because the EU covers all its costs.

The second pillar is that we have a key role to play in the consolidation of the Hungarian financial and energy sectors. Last year a government SPV purchased Budapest Bank and we are planning to buy some of the equity of other commercial banks on behalf of the government. We may also have a role in financing the utility sector. Some foreign investors are looking to exit the energy sector in Hungary and the government will probably buy their stakes from them.

We will probably have a role in financing these utilities. The responsibilities and future tasks are being discussed by the government, but this will certainly require substantial funding, which is why last December we issued a very well received €300m six year eurobond.

One key takeaway from this transaction was that there was huge interest from local investors. This is because before the conversion of FX household mortgage debt, banks had huge euro assets but small euro deposits. The conversion meant that banks had to find an outlet for their euro deposits. This explains why more than 40% of the transaction was bought by local investors, which was quite a new phenomenon for us.

The pricing was quite tight. But we would like to focus on local funding — which does not necessarily mean local currency funding, but funding from local investors and banks which have huge appetite for euro assets. Funding capacity in HUF is also quite substantial, and we think local products probably have a price advantage compared with issuance in the Eurobond market where we believe the sovereign rating still has a disproportionate influence on pricing.

Also, because the debt management office has not issued a eurobond for a while, it is not just the sub-investment sovereign grade rating that is a problem for Hungarian borrowers.

The other issue is that the longest Hungarian government bond in euros matures in 2020. This was another factor which influenced our issuance — our bond was one and a half years longer than the longest

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**GlobalCapital: What about MVM’s funding plans? Your latest investor material refers to rising investment in renewables in line with the national plan of increasing the share of renewable energy in total consumption from 7% in 2010 to 15% by 2020, for example. How will this be funded?**

**Gyorgy Kobor, MVM:** Last year we saw tremendous liquidity in the banking market, which comfortably met our requirements for refinancing our debt portfolio. Although a bond issue isn’t under immediate consideration, we are listening to proposals on funding options from a number of investment and commercial banks, and we have put out an RFP for a ratings advisory procedure.

An upgrade for the sovereign would be a key issue for us, because although our standalone corporate profile would probably merit an investment grade, our rating probably would be linked to the government’s rating.

We haven’t yet made a decision on our financing strategy because funding costs in the bank market are very low. We were able to refinance last year at very attractive margin levels of below 150bp. The reason we are looking at the bond market is that we have recently adopted a new strategy. We are now focusing on areas like renewables and other opportunities for diversification. Additionally, we have assets which have a lifetime of 20 or 30 years, whereas our existing funding has an average maturity of five years, so there is clearly a mismatch between our assets and liabilities. Tenors are being extended in the banking market, and we are increasingly being offered seven or eight year money, but we would like to close this gap, so from a risk management perspective it may make sense to use the bond market. But there are many aspects of our funding strategy that are still under consideration.

**GlobalCapital: What is MVM’s annual funding requirement?**

**Kobor, MVM:** The total long-term committed debt portfolio of MVM is about €1.5bn, but our future funding requirements will be dependent on our strategy. We expanded into Slovakia last year and we are looking out for assets overseas, which would require funding.

How much funding we will need will be decided over the next couple of months.

**GlobalCapital: How are the funding plans of Hungarian Development Bank (MFB) evolving?**

**Marton Kerekes, MFB:** Currently MFB’s activities are based around three major pillars. Probably the most important of these is funding the SME sector by channelling EU refundable financial assets into the economy.

MFB only has a pass-through role so this we are distributing an EU product which we expect to be popular in Hungary. In our role as a distributor, we provide the necessary risk management, operational support, IT and human resources, but the sales points will be commercial banks. We have now hired more than 400 commercial bank branches to place these products, and we will probably enlarge this distribution network by another 100 or 200 branches, which will give us a very large nationwide branch network. Unfortunately EU regulation means that this won’t cover central Hungary, which is regarded as being too developed as a region. So we will plan to develop a new product of our own for central Hungary.

The SME product is a pretty sizeable programme for 2016-2020 which is worth about €1.2bn, but it won’t require any additional funding because the EU covers all its costs.

The second pillar is that we have a key role to play in the consolidation of the Hungarian financial and energy sectors. Last year a government SPV purchased Budapest Bank and we are planning to buy some of the equity of other commercial banks on behalf of the government. We may also have a role in financing the utility sector. Some foreign investors are looking to exit the energy sector in Hungary and the government will probably buy their stakes from them.

We will probably have a role in financing these utilities. The responsibilities and future tasks are being discussed by the government, but this will certainly require substantial funding, which is why last December we issued a very well received €300m six year eurobond.

One key takeaway from this transaction was that there was huge interest from local investors. This is because before the conversion of FX household mortgage debt, banks had huge euro assets but small euro deposits. The conversion meant that banks had to find an outlet for their euro deposits. This explains why more than 40% of the transaction was bought by local investors, which was quite a new phenomenon for us.

The pricing was quite tight. But we would like to focus on local funding — which does not necessarily mean local currency funding, but funding from local investors and banks which have huge appetite for euro assets. Funding capacity in HUF is also quite substantial, and we think local products probably have a price advantage compared with issuance in the Eurobond market where we believe the sovereign rating still has a disproportionate influence on pricing.

Also, because the debt management office has not issued a eurobond for a while, it is not just the sub-investment sovereign grade rating that is a problem for Hungarian borrowers.

The other issue is that the longest Hungarian government bond in euros matures in 2020. This was another factor which influenced our issuance — our bond was one and a half years longer than the longest
outstanding euro government issue, which created a pricing challenge for investors.

I don’t know whether this was the case with the recent MOL transaction, but we did a six year issue maturing in December 2020 where there is no natural benchmark for corporate investors, whereas MOL’s was a seven year deal. Some investors used the US dollar sovereign curve to price our transaction, while others based their calculations on an extension from the euro curve.

Our third pillar is product innovation. In 2017, the central bank will probably withdraw its Funding for Lending programme. If we have sufficient credit and GDP growth, this product — which is a monetary stimulus — will come to an end thanks to the fact that it will have fulfilled its goal. As a national promotional bank, we can then step in because providing funding for SMEs and municipalities is our major goal.

GlobalCapital: How big is the domestic investor base, and how do Hungarian investors allocate their assets under management?

Cerny, Erste Group: CEE-based insurance companies, investment and pension funds have become more influential players, also in international issues out of the region, but the main source of liquidity — in Hungary as well as in other CEE countries — is still the banks.

GlobalCapital: Coming back to AKK’s funding strategy, how important is the retail investor in Hungary?

Barcza, AKK: Our goal is to keep Hungary on a sustainable growth path. In the past 40 years the country suffered balance of payments crises maybe half a dozen times, so one of the priorities is to ensure that we avoid the risk of a similar crisis in the future. One way to do this is to draw on domestic savings by maximising the financing by retail investors of the increase in the nominal debt – the budget deficit plus or minus EU funding. This means that supply in the wholesale market in nominal terms can remain unchanged. This is the path we can take to guarantee that even if the nominal debt increases, as long as we have a nominal budget deficit, we can avoid the risk of any balance of payments problems.

At the present time, we’re in a fortunate situation because bank deposit rates are so low. So we’re using this opportunity to develop this strategy of increasing retail participation in the government bond market. Last year and this year we achieved this objective, but the retail market is very volatile, so sometimes a 25bp move can change market demand by three or four times.

GlobalCapital: What is your main competitor for the attention of Hungarian retail investors? Do they buy equities?

Barcza, AKK: Bank deposits are clearly the main competitor. The most popular product among retail investors at the moment is the one year Treasury bill, followed by the six month bill. This year we have significantly reduced the interest rate on these short term products, and increased the rate on longer term products. We also have inflation-linked bonds with three and five year maturities and index-linked floating rate bonds with four, six and 10 year maturities, and in recent weeks we have seen an increase in demand for these instruments.

We’d like to increase the retail share, but the retail market in Hungary is already large by international standards. Just over 30% of the public debt market is accounted for by retail investors, which made Hungary by far the largest market among the 40 countries that attended a recent retail debt management conference in Washington. A number of people have approached us to ask about our experience in this market because several other countries would like to increase retail participation as we have done in Hungary.

We sell Hungarian state treasury debt directly to retail investors, as well as through the banks. We pay a 1% fee for issuing a simple one year Treasury bill via the banks. I’m grateful for this arrangement. Many debt management agencies see the banks as their competitors to retail investors, but we believe that you need them in order to distribute government debt efficiently.

Cerny, Erste Group: Just to make some closing remarks from the perspective of the debt capital markets, AKK has done an excellent job in developing the local market and establishing a benchmark yield curve, also at the long end. It would be great if it can do the same for the private sector in the international market. We believe the ECB’s recently introduced Corporate Sector Purchase Programme (CSPP) will also drive down margins for corporate borrowers in CEE as well as in the rest of Europe, so this is an ideal time for Hungarian borrowers to be looking at opportunities in the bond market.
RMB: New Choice

Bank of China, the leading provider of RMB solution:
• Foreign Exchange
• Fixed Income
• RMB Bond Underwriting Onshore & Offshore
• Agency Service in China’s Interbank Bond & FX Market
• Cross-border RMB Clearing