Non-resident Investors in the Local Currency Market
– the case of Hungary

World Bank Webinar
András Réz, ÁKK Head of Planning, Research and Risk Management
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Agenda

1. The Macroeconomic Situation in Hungary,
2. Public Debt of Hungary,
3. How to Attract Non-resident Investors?
4. Pros and Cos of Non-resident Investors in the Domestic Market,
5. Monitoring Non-resident Investors in the Domestic Market,
The Macroeconomic Situation in Hungary

After the crisis in 2008-9 Hungary underwent a large adjustment which balanced the economy and the public sector. Current account is positive, public debt ratio started to decline. Macroeconomic correction still has a cost in the growth rate.
Debt ratio increased steadily to above 80pc by 2010
Share of FX debt increased up to 50pc during 2008-11 (role of IMF/EU FX loan)

Government’s objective is a gradual decline of the debt ratio and higher share of domestic debt in the 2010s
1. Financing problems of Hungary in 2008-9 was associated with a sizeable decline of non-resident ownership of domestic bonds
2. After macroeconomic adjustment – improved deficit and C/A - non-resident investors returned from 2010
3. Households became an important investor group beside the previous 3 (foreign investors, banks, pension & insurance)
4. The role of pension funds declined because of pension reform.
How to Attract Non-resident Investors?

- Non-resident investors were always important investors of Hungarian public debt, but usually in foreign currencies,
- Hungary is a regular issuer in the international market, and its domestic securities market is well developed (yield curve up to 15 years),
- Building up large bond series by reopening old series (liquidity is important for non-resident investors)
- Institutional framework was established in the 1990s (debt office, settlement, benchmarks and indices were published),
- As a part of joining the European Union market standards (yield calculation, interest payment frequency) was adjusted to international standards
- Primary dealer system is a key factor in building and developing primary and secondary market of government securities, with a role of inviting investors to the market,
- Foreign banks were PDs since 2008 and remote PDs were allowed in 2010. At present 6 PDs are foreign or remote out of 14,
- ÁKK have regular non-deal roadshows, and bilateral investors meeting to attract non-resident investors.
Pros and Cons of Non-resident Investors in the Domestic Market I

- The main reason for attracting foreign investors to the local currency debt market is to increase investors base and competition
- Domestic investor base can be limited, oligopolistic and demand sorter term securities
- Foreign investors compete with local investors pushing yields downwards
- Foreign investors can demand usually longer term securities therefore developing domestic yield curve
- Given the limited absorbing capacity of the local investor base non-resident investors are needed to finance extra budgetary programs
Pros and Cos of Non-resident Investors in the Domestic Market II

• The main element of risk associated with non-resident investments in local currency instruments is the potential drastic sell-off during a crisis

• Non-resident investors can invest or divest at the same time as a reaction to global or regional events – that may result in difficult-to-manage large swings

• Between the middle of September 2008 and beginning of December 2008 (merely 2.5 months time) non-resident holdings of Hungarian government securities fell by HUF 942 billion (approximately EUR 3.6 billion)

• To put it in contrast: GFS based general government deficit for the year 2008 amounted to HUF 990 billion

• This is a low probability event but with strong adverse effects

• ÁKK manages this risk with higher cash buffers after the crisis for longer period of market stress and develop liquidity management
Monitoring Non-resident Investors in the Domestic Market

- Monitoring is extremely difficult due to lack of detailed data
- Bloomberg covers a plethora of entities (holding approximately 40% of HUF instruments owned by non-residents) based on SEC reports;
- These entities are US funds; no reliable information available for the rest of the market
- One-on-one meetings can be of some use
- In Hungary Templeton is the largest investor and as such monitored with distinction
- KELER (clearing house in Hungary) provides no detailed data
- KELER provides aggregate data of non-resident investors on a daily basis
Lessons learned

- Foreign investors are important group of investors in debt management
- Exchange rate risk can be reduced by inviting non-resident investors into the domestic market which help develop the market (but with some risk)
- Non-resident investors require a certain degree of domestic market development and prudent macroeconomic policy – and their participation support further developments
- Risk stemming from too high foreign ownership can be reduced with balanced maturity profile and high duration and cushion buffers
- During a crisis foreign investors can sell their portfolio which can limit the DMO access to market by auctions
- Balanced investors base is needed with strong local investors base
Thanks for your attention!

More info on Hungarian public debt management at:
www.akk.hu