

Promoting the Development of Domestic Capital Markets: Hungary: a case study

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List of Problems

- FX loans to domestic customers, including especially risky CHF-loans to unhedged retail borrowers → asset quality problems
- Currency mismatch in banks' balance sheets → permanent massive need for FX swaps
- Excessive reliance on wholesale funding → vulnerability to volatile wholesale risk spreads
- Excessive reliance on external funding → exposure to global market and parent bank behaviour
- Massive maturity transformation in banks' balance sheets → funding, liquidity & interest rate risk, **eventually more expensive funding**
- Wide interest margin on the domestic credit market → more costly financial transition, **a drag on economic growth**

Is a Domestic Capital Market a Solution?

- FX loans: **Partially**, as banks lent in FX in view of massive interest rate differentials, not as they lacked LCY funds. But an alternative source to banks can put pressure on HUF borrowing costs.
- Currency mismatch: **No**, it is FX funds that are actually missing.
- Wholesale & external funding: **Partially**, as funding from domestic capital market is wholesale as well. But an alternative supplier can reduce funding risk and contain funding costs.
- Maturity transformation: **Definitely yes**, as shorter-term savings can be transformed into long-term funds if invested in readily marketable instruments.
- Wide interest margin: **Yes** again, as an advanced domestic capital market can put competitive pressure on banks on both the asset and the liability sides.

State of Play & Ingredients of Success

- Institutional & legislative infrastructure: Largely there, as to the means and vehicles of issuance, trade, settlement, asset management – relatively **little to do** on this.
- Investor base: Also there, comprising domestic individual and institutional investors + the rest of the world – **no action needed**.
- Issuer community: Partially there, but restricted to banks and a narrow circle of non-strategically owned big domestic companies and a few sufficiently transparent and trackable medium size firms. Further development should be **market-driven, supportive action** may be useful.
- Economic & financial conditions: HUF capital market expensive for issuers, sovereign and currency risk to be reduced. Relatively **lot to do** on macroeconomic and structural policies, financial stability.