Financial Risk&Regulation

Trends in the Hungarian securities market

Newsletter – May 2024

The composition of Hungary's securities portfolio has seen a significant reorganization over the past four years following the Covid-19 crisis, according to statistics from local lending and financial institutions, as well as domestic money market funds. This brief overview highlights the evolving trends[1] in the composition of Hungary's domestic securities in response to the shifting interest rate landscape.

Overview of the domestic interest rate environment

Inflation in Hungary peaked at the end of 2022 and has been gradually decreasing since then. Today, the Central Statistical Office (KSH) has measured inflation at 3.7%, which is consistent with the values before the crisis following Covid-19. In line with this, after maintaining the base rate at 18.0% for six months, the National Bank of Hungary (MNB) began gradually reducing the exceptionally high interest rate environment from May 2023, resulting in the current base rate of 7.25%. This favorable direction is also shown by the BUBOR and BIRS interbank interest rates following the decrease in the base rate..

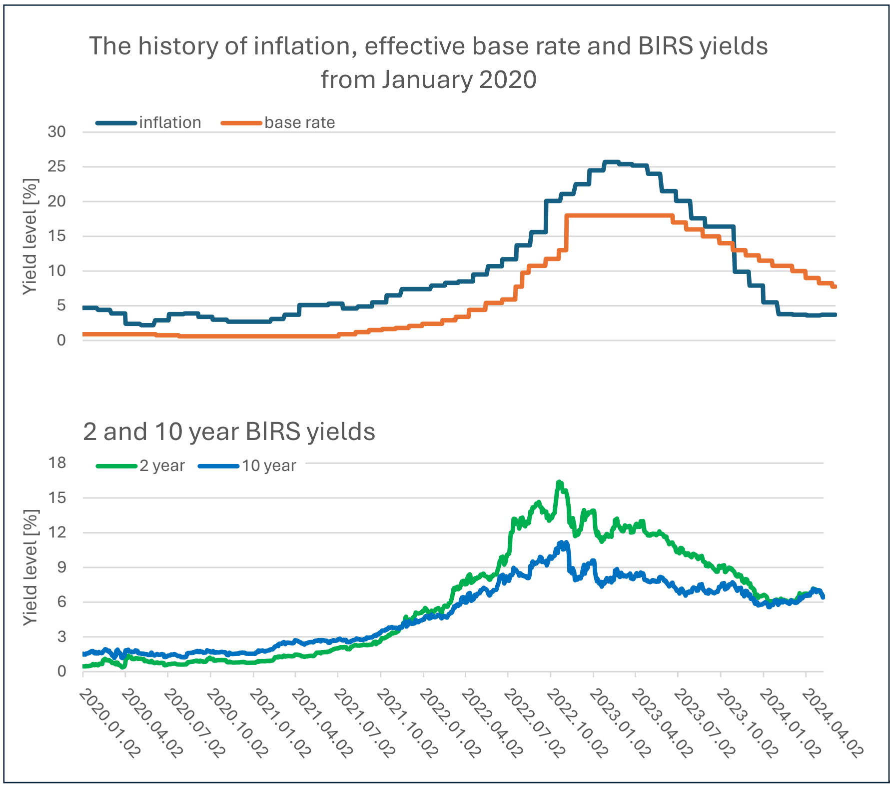


Figure 1:

(Upper panel) The change in inflation and the effective reference rate (base rate) since January 2020. The base rate between May 2022 and October 2023 is the overnight deposit quick tender with unlimited acceptance, otherwise, it is the central bank's reference rate.

(Lower panel) The development of 2 and 10-year BIRS yields since January 2020.

1 For the analyses we used MNB's monthly report on the stock of domestically issued securities in circulation.

The market shows a positive mood by the fact that even though the MNB predicts that inflation will keep rising this year and is likely to come back permanently to the central bank's tolerance band only by 2025, the BIRS interest rate spread (the gap between the two-year and 10-year interest rates) has fallen from the almost -4% usual at the inflation peak to -0.2% by the end of March: the inversion of the interest rate curves seems to be gradually reversing, indicating that trust in stabilization is increasing. This is also shown by the fact that the 1-year forward interest rate curve already displays a normal rise of +0.3%.

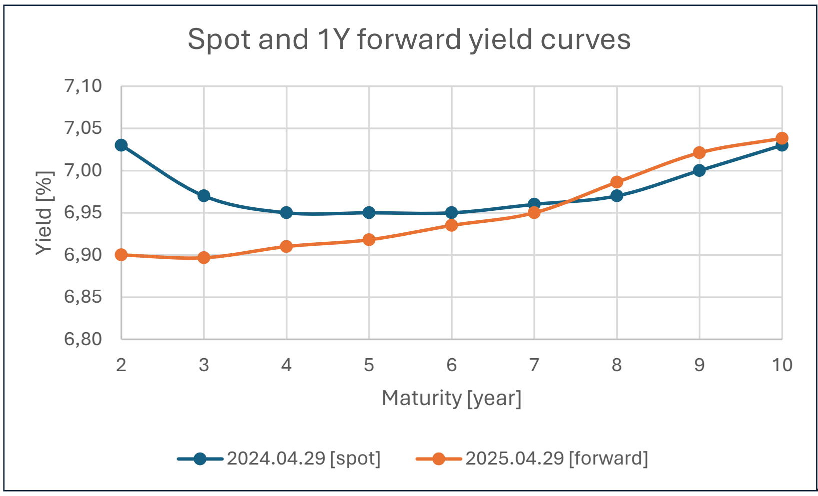


Figure 2.
Spot and BIRS yield curves observed on 29th April 2024, with maturities ranging from 2 to 10 years. Linear interpolation was applied for the calculation. The yield level scale, which varies by a few tenths of a percentage point, clearly shows the nearly flat nature of the curves, indicating a shift from an inverted interest rate environment.

The forward yields calculated based on BUBOR also show that the market expects further decreases in interest rates, but reflects a slightly more cautious picture. Comparing the past three-month gradient in BUBOR with the slope in market expectations given by forward interest rates, it is evident that the market is currently pricing in a significantly slower rate of interest rate decrease, almost stagnation.

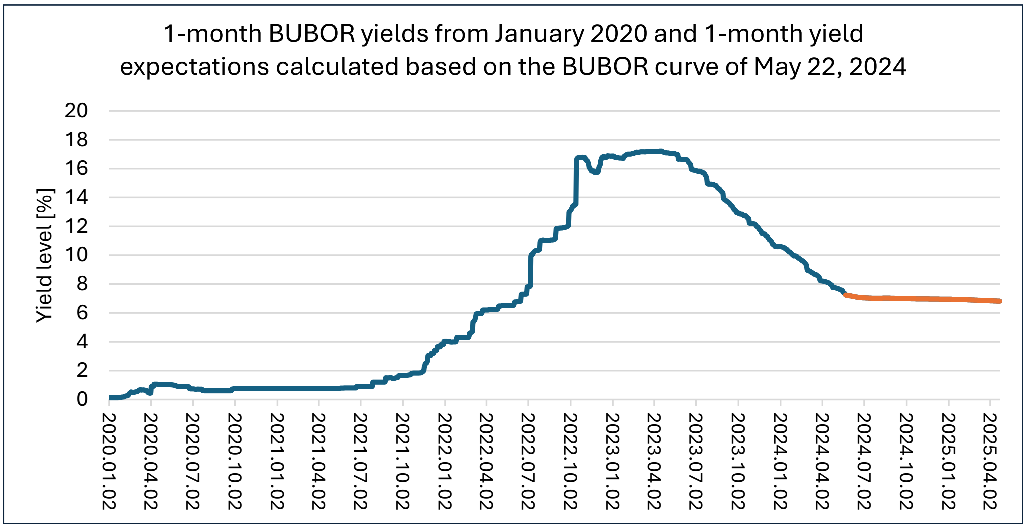


Figure 3.
1-month BUBOR yields from January 2020 to May 22, 2024 (blue curve), and 1-month forward yields calculated based on the BUBOR curve as of May 22, 2024, extending to May 22, 2025 (orange curve).

Yield Curve Characteristics

Yield curves indicate the interest rate structure of investments or, similarly, loans as a function of maturity. Accordingly, the shape of the curve carries important information about future market expectations.

Normal curve: Under normal market conditions, when there is an outlook for long-term economic stability, an upward-sloping yield curve trend can be observed: the longer someone is willing to forgo their money, the higher the yield premium they are rewarded with. Such a yield curve shape was observed before the crisis caused by the Covid pandemic.

Inverted curve: In an unstable, unpredictable market environment, due to restrictive monetary policy, the market cannot guarantee exceptionally high short-term yields in the long run, resulting in a downward-sloping yield curve. In a dynamically growing and high inflation environment, an inverted yield curve was observed.

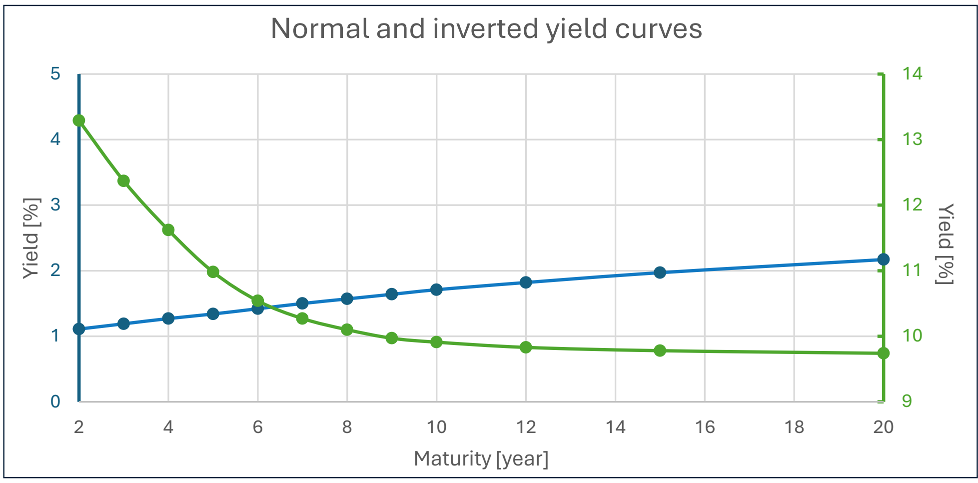


Figure 4.

Characteristic normal and inverted yield curves: BIRS yield curves observed on January 1, 2020, and October 3, 2022. In the case of the inverted curve, the interest rate spread (the difference between 2-year and 10-year maturities) is nearly 4 times larger in absolute terms than in the normal curve. Such a large difference is also a characteristic feature of the relationship between normal and inverted yield curves.

Investor trends in the domestic securities market

Issuer structure

For our analysis, we categorize the most actively traded domestically issued securities as follows, based on the groups used in the reports of the MNB (National Bank of Hungary) regarding the statistical balance sheets of domestic credit institutions[2], the Hungarian branches of foreign credit institutions, and domestic money market funds.

Debt securities:

- Central government bonds in forint and foreign currency
- MNB bonds (forint and foreign currency)
- Mortgage bonds (forint and foreign currency)
- Other credit institution bonds (forint and foreign currency)
- Other sectors, financial and non-financial corporations, local governments

Equity Securities:

- Investment units: issued by money market and non-money market funds
- Listed shares: issued by non-financial corporations, other monetary institutions, and other sectors

Regarding the change in volume, there has been a general increase, with the total holdings nearly doubling over the past four years, growing from HUF 50 trillion to HUF 95 trillion. While growth was observed in every issuing sector, the most dynamic increases were seen in credit institution and other corporate bonds, with a 473% and 354% growth in stock, respectively, as well as in investment fund shares, which grew by 144%.

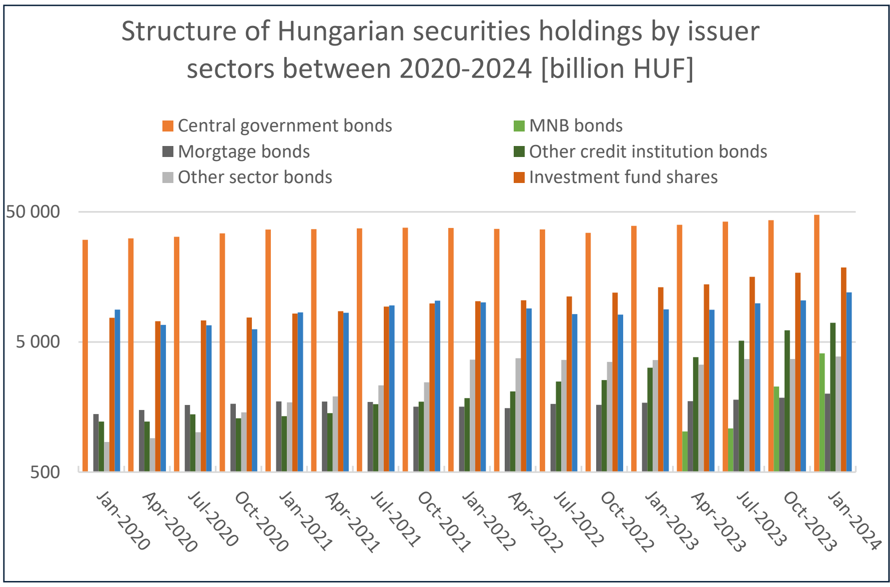


Figure 5.

Development of the stock of domestic securities between January 2020 and January 2024. We used a logarithmic scale on the holdings volume axis.

2 Financial institutions based in Hungary, without data on their foreign subsidiaries.

Change in the distribution of domestic securities holdings by asset families

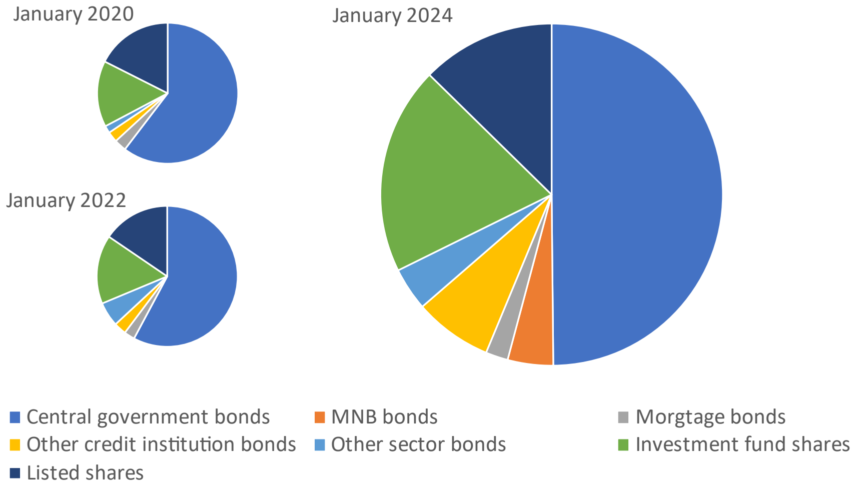
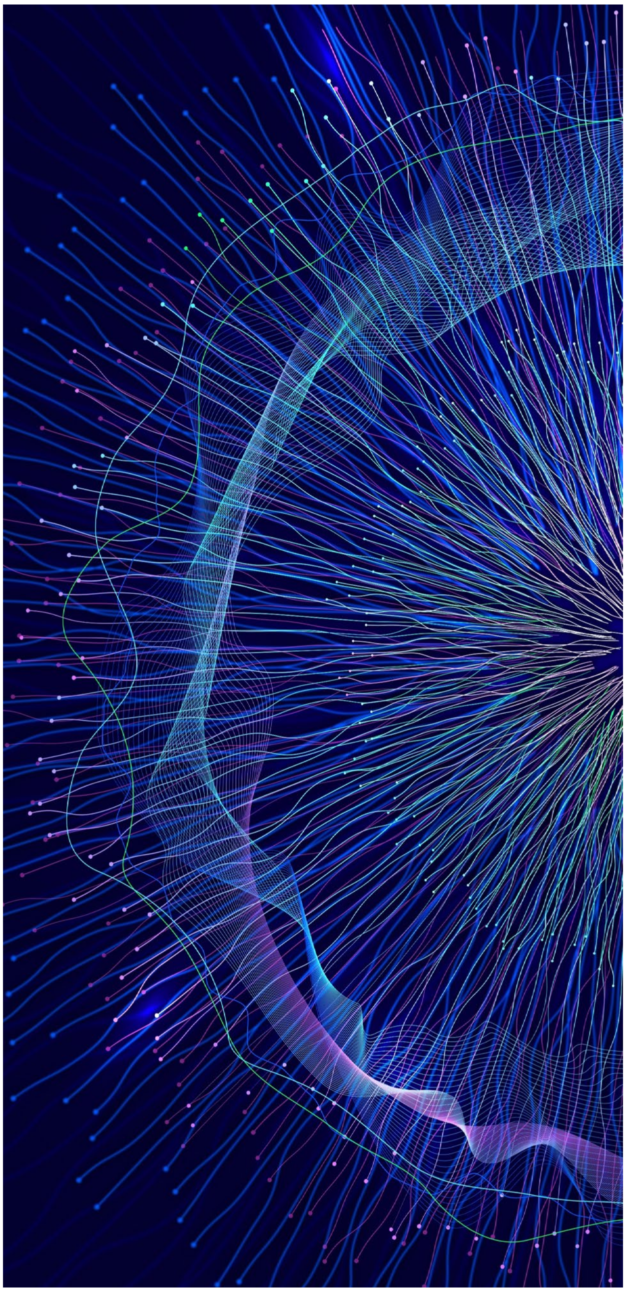


Figure 6.
The share of the various asset families in the portfolio of domestically issued securities.

Alongside the general growth of holdings, there has been a significant reorganization of the domestic securities stock in terms of sector shares in recent years. Following 2020, market recovery was observed due to government measures worldwide aimed at mitigating and halting the crisis caused by Covid-19. In parallel with the initiation of postponed investments during the crisis and the impact of the Growth Bond Program (Növekedési Kötvényprogram) domestically, companies began issuing bonds in large volumes. As a result, the proportion of corporate (and other non-credit institution or government) bonds in the domestic securities stock increased from 1.7% at the beginning of 2020 to 5.6% by the end of 2021. This corporate bond issuance wave was halted by both the phasing out of the program and the soaring inflation at the end of 2021. Since then, the stock has stagnated, and due to the growth in the volume of other, safer investments, the market share of corporate bonds has decreased back to 4.1%.

From mid-2021, with the strengthening of inflation, the share of bonds issued by financial institutions in the market showed a significant increase, growing from 2.8% in January 2022 to 7.4%. Concurrently, the MNB bonds introduced at the beginning of 2023 now make up 4.3% of the domestic securities portfolio. Similarly, the market share of investment certificates experienced dynamic growth, from 15.8% (January 2022) to 19.7% (January 2024). The growth of the above sectors primarily occurred at the expense of the shares of bonds issued by the central government, mortgage bonds, and domestic stocks: there was a decrease of 10.5 percentage points in central government bonds, 0.7 in mortgage bonds, and 4.8 in stocks over the past four years.



Ownership distribution

The securities market is mainly dominated by the portfolio held by financial institutions, households, and non-resident owners, both for securities that represent credit and ownership relations. For households, the portfolio grew by 50.3% in the last 2 years, and by 87.7% since January 2020. For financial institutions, these growth figures are 29.1% and 67.1%, while for non-resident investors: 57.3% and 75.8%. However, the overall growth trend did not alter the market's investor structure significantly: the shares of the ownership sectors remain stable, with no major changes occurring in the past 4 years.

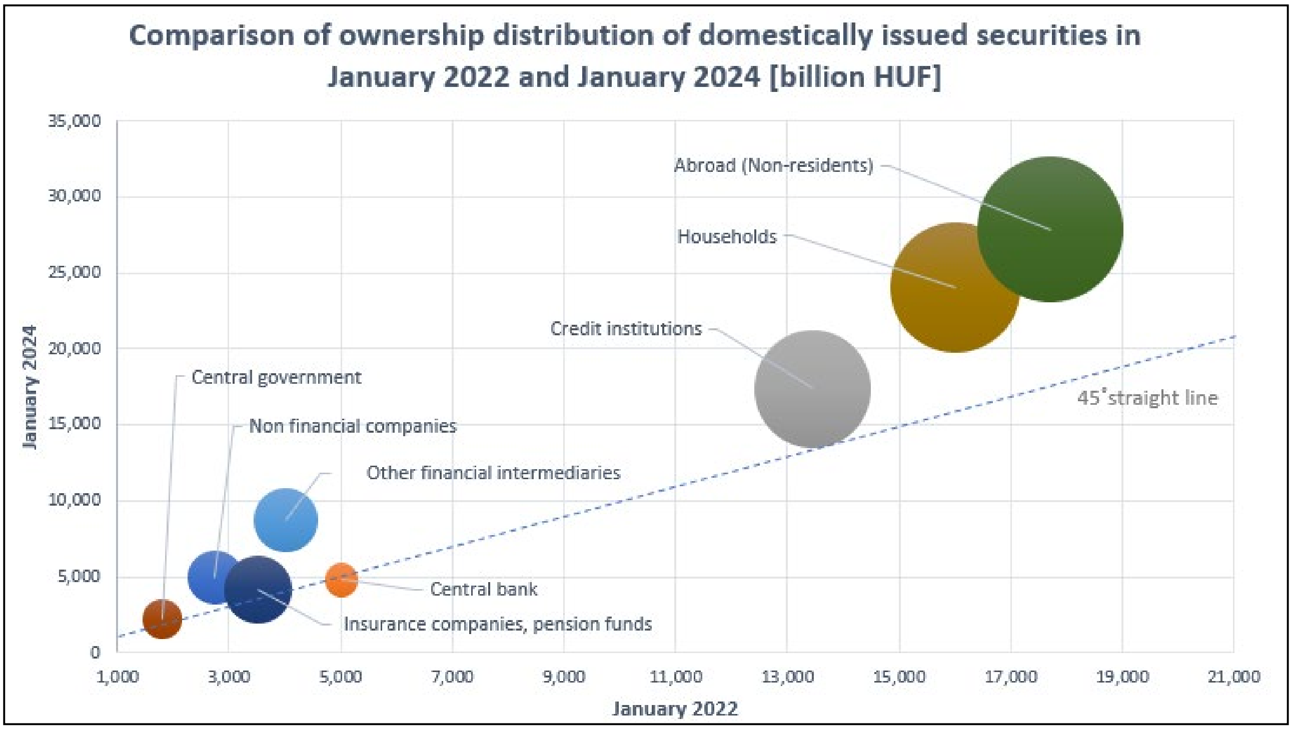


__Figure 7.__ Changes in the ownership distribution of domestically issued securities between January 2022 and January 2024. The size of the data points is proportional to the size of the owner stock in January 2020.

Ownership sectors	January 2020	January 2022	January 2024	Proportion January 2024
Non financial companies	2,228.0	2,748.1	4,991.0	5,2%
Central bank	840.3	5,013.9	4,791.9	5,0%
Credit institutions	10,393.7	13,458.3	17,372.2	18,3%
Money market funds	21.9	8.1	39.3	0,04%
Other financial intermediaries	3,006.8	4,014.7	8,735.7	9,2%
Financial auxiliary service providers	126.8	174.7	321.2	0,3%
Insurance companies, pension funds	3,480.8	3,507.1	4,173.4	4,4%
Central government	1,197.4	1,802.9	2,221.2	2,3%
Local governments	347.1	177.1	90.5	0,1%
Households	12,816.8	16,007.8	24,060.7	25,3%
Nonprofit institutions helping households	202.8	450.4	495.9	0,5%
Abroad (Non-residents)	15,846.3	17,714.2	27,862.9	29,3%
Total Stock	**50,508.7**	**65,077.3**	**95,155.8**	**100,0%**

The Hungarian economy may benefit from the lower inflation in 2024, which would ease the pressure on domestic investors, but the macroeconomic risks remain significant. The question is how high geopolitical tensions, the elections in the US and Europe, as well as Hungarian central bank and budgetary processes will bring new directions in investor trends, and in what direction they will shape the future domestic securities market, its structure, and volume.

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Achieving success requires a thorough understanding of market and environmental factors, as well as a deep comprehension of business processes and developments. KPMG's team of risk management experts is at your disposal to compile wide-ranging, objective, professional analyses of market sectors and processes.

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