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Positive trends on the government securities market

In addition to a stable central government budget and low current account deficit achieved in Hungary, the financing conditions of external debt have also been improving steadily. On 5 September 2017, the Government Debt Management Agency (ÁKK) issued 3-month Discount Treasury Bills with negative yields – for the first time in its history.

In recent years, Hungary's external and internal balance indicators have improved, along with the financing conditions of government debt. The deficit of the central government budget remained below 2 percent of GDP in both 2015 and 2016, while back in 2011 it was as high as 5.5 percent. In addition, the current account closed the year 2016 with a record-high surplus that accounted for 4.9 percent of GDP. In the period 2011-2016, the gross debt of the central government budget fell from 74.4 percent of GDP to 72.6 percent. This positive downward trend is expected to persist in coming years.

According to a recent report published by the Government Debt Management Agency (Financing of the central government in July, 2017), the debt-to-GDP ratio was determined by two contradicting trends in the first half of the year. On the one hand, the issuance of retail government securities has increased (this amount was used to lower state debt and finance maturing foreign currency bonds). On the other hand, favourable forint and foreign currency exchange rates as well as net foreign currency redemption have reduced the debt-to-GDP ratio. By the end of July 2017, the forint-denominated debt of the central government budget rose by HUF 1165bn, while the foreign currency debt was down by HUF 408bn. Accordingly, the share of forint-denominated debt was up by 3 percentage points, to 75.6 percent, whereas that of forex debt edged down by 2 percentage points, to 22.6 percent, compared to the end of 2016.

At the end of July 2017, the largest share, 44.5 percent, of central government debt was issued in the form of government bonds, down by 0.5 percent compared to the end of the previous year. The stock of retail government securities grew dynamically in the first half of 2017, hitting 24.5 percent of the total volume of debt at the end of July. This figure is already higher than the current share of foreign-currency denominated debt (22.6 percent), the result of a declining trend. The total stock of Discount Treasury Bills accounted for 3.2 percent of central government debt at the end of July 2017, also due to a slight decrease (ÁKK: Government Securities Market, Monthly Report, July 2017).

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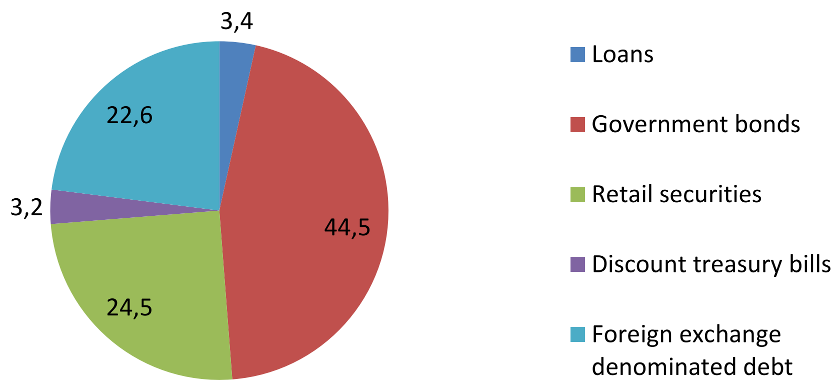
Fig.1. Central Government Debt structure (%), July 2017



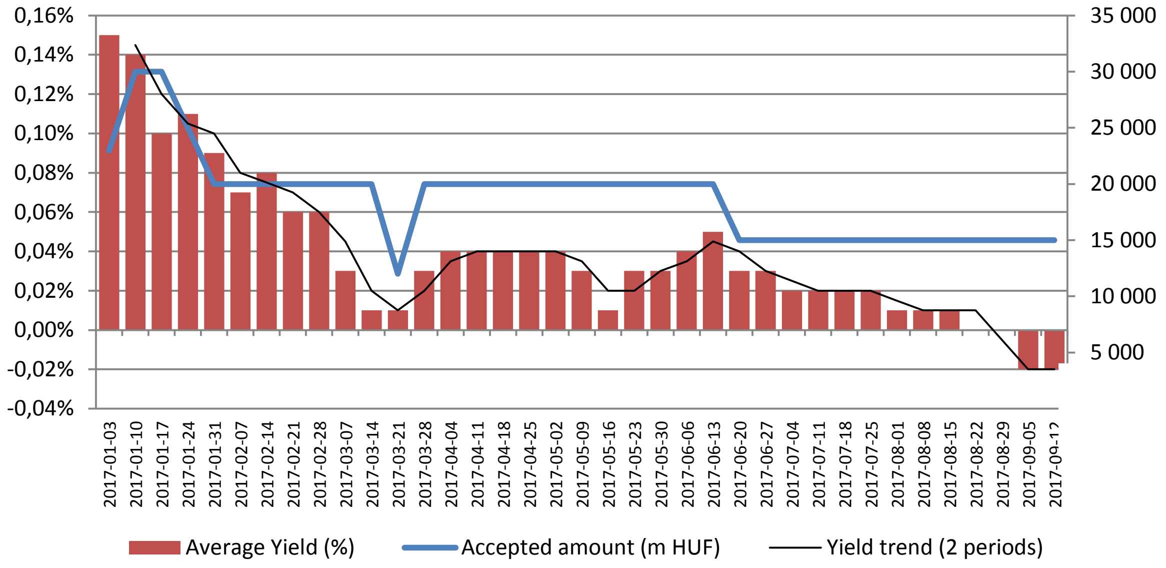
Source: ÁKK Monthly Report July 2017

Fig. 1 shows the composition of central government debt. Within the total volume of forint-denominated government securities, Discount T-Bills had a larger share of 4.9 percent, but the largest categories were fixed-interest government bonds (with a share of 58.2 percent) and retail securities (20.8 percent) at the end of the first half of 2017.

At the auctions for Discount T-Bills and especially for 3-month Discount T-Bills, as bids received had well exceeded the amount offered, average yields have fallen to all-time lows. Average yields had been around 0 percent already in July 2017, and favourable external and internal processes have caused yields on 3-month Discount T-Bills to slip into negative territory (-0.02 percent) at the auction of 5 September 2017. (This was the first time that minimum, maximum and average yields have all become negative. A negative minimum yield had been reached earlier.) At the next auction, on 12 September, yields of Discount T-Bills were once again similar. (www.akk.hu)

Fig.2. Results of 3-months Discount Treasury Bill auctions, 2017

(Average yields – left axis (%), accepted amount of bids – right axis (M HUF))



Source: www.akk.hu

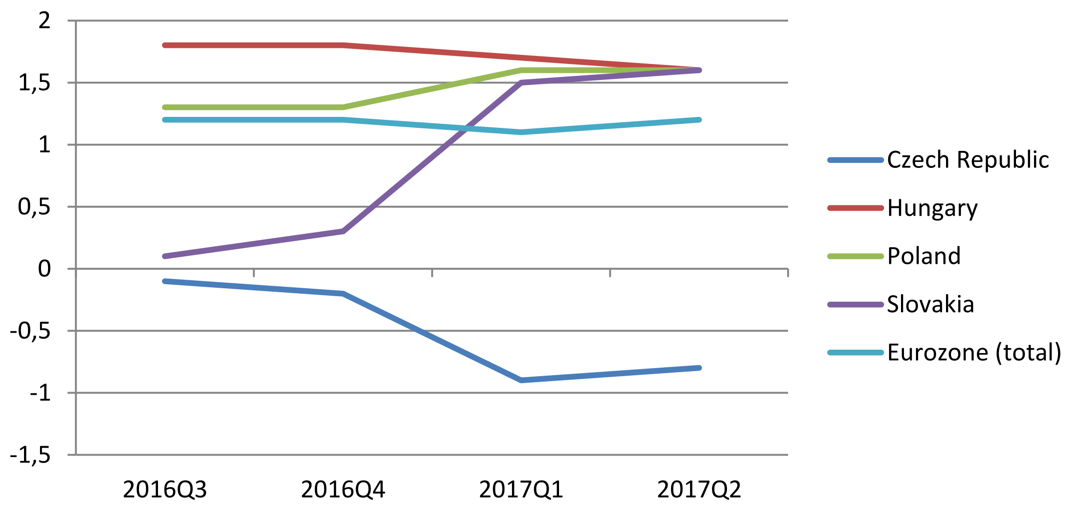
The positive outcomes of the issuances of government securities are believed to have stemmed presumably from the fact that investors see Hungary as a country with a predictable and stable economy, and this foretells further decreases in yields. This, in turn, enables the state to generate some (modest) profits through debt financing.

The sentiment of financial markets in the Central and Eastern European region is generally upbeat, and other countries of the region have also seen high bid-to-cover ratios at recent auctions. Accordingly, the sale of government securities has been in line with prior issuance plans in each country within the region. In the *Czech Republic*, Discount T-Bills in the value of CZK 143.7bn (EUR 5.4bn), the equivalent of some 8.3 percent of the government's debt, were issued in the first half of 2017. The average weighted annual yield of these T-Bills was -0.76 percent. These T-Bills, however – which are redeemed prior to the end of the year – are not used in the Czech Republic for the financing of central government debt: they are to generate extra revenue through negative yields (Ministry of Finance Debt Portfolio Management Quarterly Report, 1st Half of 2017). In *Poland*, four auctions have hitherto been held this year with short-dated T-Bills, at which average yields ranged between 1.55 and 1.52 percent. (http://www.nbp.pl/homen.aspx?f=/en/dzienne/rynki.htm). In *Romania*, Discount T-Bills accounted for some 22.3 percent of debt issued by the end of May 2017, with average yields around 1 percent (Ministry of Finance Public Debt Report, June 2017).

Although the European Central Bank (ECB) does not publish detailed data on the auction of Discount T-Bills for each member state, data of the financing of state debt nonetheless show an intriguing picture. In light of statistics available in the ECB data base, there are remarkable differences in the volume of transactions and nominal yields of government debt securities not only between the countries inside and outside of the eurozone but even within various CEE countries (ECB: Debt securities issuance and service by EU governments, 2017 July). The total transaction issuances of government debt securities varied between EUR 0.3-19.4bn per country in Q3-Q4 2016 and in Q1-Q2 2017, with a much higher amount auctioned in Poland and Hungary and much smaller ones seen in the Czech Republic and Slovakia. Nominal yields, however, tended to converge at these auctions, except for the Czech Republic, where negative yields have persisted since 2015.

Fig.3. Nominal yields on government debt securities' issuances

(Percentages per annum, residual maturity up to one year)



Source: ECB July 2017

As Fig. 3 demonstrates, nominal yields in Hungary, Poland and Slovakia averaged 1.6 percent at issuances of government debt securities in the second quarter of 2017, slightly above the respective average of eurozone member states (1.2 percent).

As a whole, Hungary – benefiting from favourable external and internal conditions – has been on the right track to finance government debt in a stable, predictable and advantageous manner as well as secure a debt structure that is less susceptible to external risks.