MINISTRY
FOR NATIONAL ECONOMY

Successful government bond swap transaction in Hungary

The Hungarian Government Debt Management Agency (ÁKK) has managed to significantly improve the composition of Hungary's central government debt as it had bought back USD-denominated securities and concurrently issued new EUR-denominated ones in the same value. Through the bond swap, the ÁKK has reduced the rate of payable interest, substantially extended maturity and rebalanced liabilities in favour of the euro, the currency more closely linked to the forint. The transaction has left the share of foreign currency debt within the total amount of debt unchanged.

At the beginning of October 2017, the ÁKK bought back USD-denominated securities of five redemption dates, ranging between maturities of one and six years in the period 2018-2023, in the value of USD 1.165bn. Parallel to that, the Agency issued a new instrument of EUR 1bn with 10-year maturity. As a result, the overall maturity curve of foreign currency debt has been extended without increasing the foreign currency debt-to-total government debt ratio.

For Hungary, the euro is a more favourable currency than the US dollar or any other international reserve currency, given the fact that the Hungarian forint is linked to the blood stream of international forex trade via the euro. In practical terms this means that while the euro-forint exchange rate is set directly during trade, the forint-dollar exchange rate is the indirect end-result of moves in the euro-forint and euro-dollar crosses. Accordingly, the relation of forint to dollar is the outcome of two concurrent factors, upon one of which – the EUR/USD rate – Hungary's economic policy has practically no influence at all. Thus, accumulating debt denominated in any currency other than the euro is a risk factor for the Hungarian state and the people of Hungary.

While the swapped USD bonds yielded between 4.0 and 6.375 percent, the newly issued euro bond bears a coupon rate of 1.75 percent. Consequently, the savings achieved through lower interest payments totals HUF 9.5bn per year. Minister for National Economy Mihály Varga has put the amount of total cost reduction, realized in the state budget thanks to lower interest rates, at HUF 50bn. ÁKK CEO György Barcza also noted that the closing of prior swap transactions and interest payments had resulted in an additional gain of HUF 30bn, and thus the overall amount with which fiscal expenditures have been reduced come to HUF 80bn.

Data of outstanding USD-denominated Hungarian government bonds (million USD)

Date of issuance	*Maturity (year)*	*Date of maturity*	*Amount issued*	*Amount offered for sale*	*Amount bought back*	*Outstanding liabilities*	*Yield*
19.02.2013.	5	2018.02.19	1 250	713	344	369	4,125%
25.03.2014.	5	2019.03.25	1 000	773	259	514	4,000%
29.01.2010.	10	2020.01.29	2 000	1 975	140	1 835	6,250%
29.03.2011.	10	2021.03.29	3 000	3 000	346	2 654	6,375%
29.02.2013.	10	2023.02.21	2 000	2 000	76	1 924	5,375%
22.11.2013.	10	2023.11.22	2 000	2 000		2 000	5,750%
25.03.2014.	10	2024.03.25	2 000	2 000		2 000	5,375%
29.03.2011.	30	2041.03.29	750	750		750	7,625%
11.04.2011.	30	2041.03.29	500	500		500	7,625%
Total			**14 500**	**13 711**	**1 165**	**12 546**	

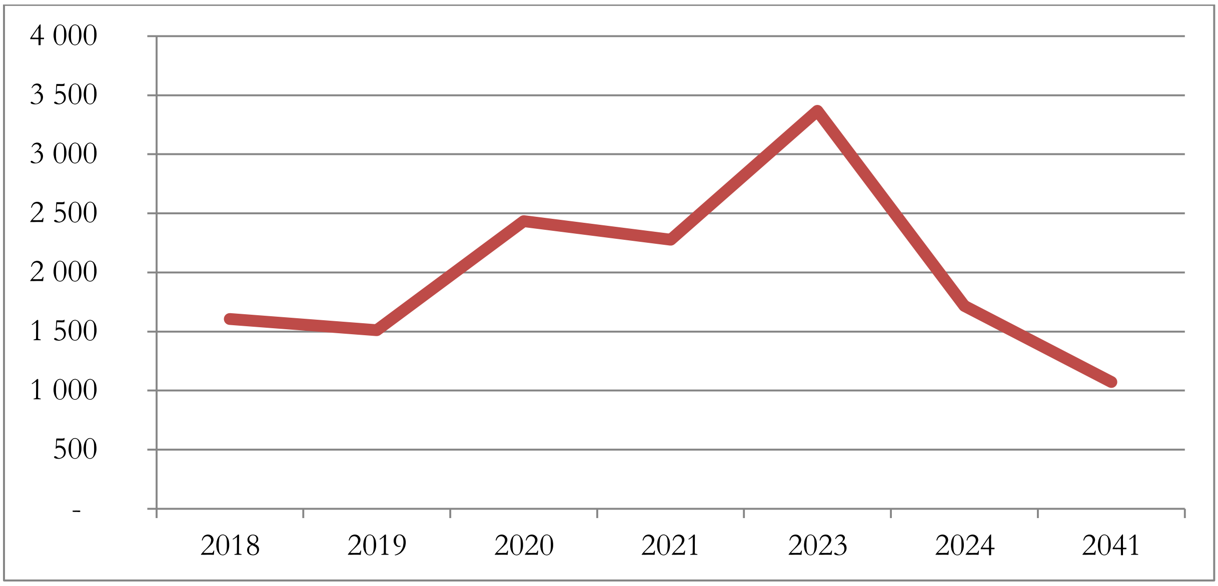
Source: Government Debt Management Agency Pte LTD

The amount originally sold through the five dollar-bond issuances had been USD 9.25bn, of which USD 8.46bn had still been outstanding prior to the buy-back tender. This amount has been reduced by USD 1.165bn, and thus the amount of USD liabilities held by investors now is some USD 7.3bn. The amount of total outstanding USD-denominated Hungarian government securities is USD 12.5bn. Excluding the two 30-year bonds with the maturity date of 2041, investors currently hold USD 11.3bn of Hungarian debt, of which the one with the longest maturity is 6.5 years.

The amount of bids originally submitted was USD 3.25bn, thus the offer was oversubscribed almost three times. The euro bond offer, on the other hand, was almost five-fold oversubscribed. In light of the successful issuance, Mihály Varga did not rule out the possibility of another similar transaction next year. In the latest EUR bond sale, the amount issued was in line with the ÁKK's prior issuance plan for this year. It is worth noting that the terms of issuance have been more favourable than those for the 10-year euro government bonds of Italy, Portugal or Romania. The new government security was also received well at the secondary market last month.

Forex bonds scheduled to be redeemed in coming years are likely to be financed by the Government from the issuance of new forint bonds. That would leave sufficient demand open for new euro bonds which could cover the swap of existing dollar bonds. In the next two years, Hungarian government bonds in the value of EUR 1.5-1.55bn are expected to reach maturity, and thus a potential bond swap is unlikely to come at a time when the market is choked by overabundant supply. The ÁKK is to publish next year's issuance plan at the end of 2017.

Hungarian foreign currency-denominated bonds by maturity (million EUR)



(at exchange rates of 7.7 EUR/CNY, 1.165 EUR/USD)

Source: Government Debt Management Agency Pte LTD

Issuance prospects as a whole are mainly positive; a similar transaction may be carried out with a larger amount issued – provided the low interest rate environment does not change unfavourably. However, currently available information points to low yields on euro-denominated bonds next year. Future bond swap transactions are expected to further stabilize Hungary's public finances due to a more optimal composition of bond maturities and interest expenditures.