

Liquidity Management in Hungary

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Institutional Setup of Liquidity Management

- Government Debt Management Agency (AKK)
 - ✓ As an institution responsible for the liquidity management of the central government since 2003 AKK carries out active and passive operations with market participants
 - ✓ The most significant factor in changing the liquidity are debt management related operations

- Hungarian State Treasury
 - ✓ Co-ordination of primary budget revenues and expenditures
 - ✓ Affecting payments for budgetary institutions
 - ✓ Forecasting of daily balances

- National Bank of Hungary (central bank)
 - ✓ Keeping of the Treasury Single Account (pays remuneration on the end-of-the-day balance)
 - ✓ Banking services for the government
 - ✓ Forecasting of daily balances
 - ✓ Offers two-week (bill) and overnight (deposit) facilities

Maintaining Liquidity fo the Budget

- The annual financing plan contains projected financing requirements and borrowing activity, but deviations are possible due to budget outturn or market demand - liquidity risk
- Government securities and money markets are sensitive to international and monetary policy shocks – even short-term financing might not always be possible in these cases
- The solvency of the budget must be maintained continuously
- All payments from and to the government are carried out from the Single Treasury Account (STA) held at the NBH
- The central bank pays a remuneration on the end-day balance of the TSA
 - ✓ No limitation of amount
 - ✓ Given market liquidity most of the time the central bank's base rate is the highest rate available in the money market, which creates a serious dilemma for the liquidity manager

Optimal Level of the TSA

- One of the 6 benchmarks AKK has to observe continuously
- AKK has to maintain the end-of-the-day balance of the TSA in a band of HUF 50 billion, where the minimum level equals to the optimal level of the TSA
- Introduced after the Russian crisis (1998) when a number of undersubscribed or failed bond auctions took place
- Originally a 4-week cash buffer, increased to 6 weeks before the current financial crisis
- Calculated on the basis of a limited market access scenario (no bond sales, only partial T-bill sales)
- The optimal level also takes account of the average error of budgetary planning (i.e. the difference between the projected monthly budget balance and the factual outcome)
- It's only in HUF, foreign currency denominated assets of the government are accounted separately

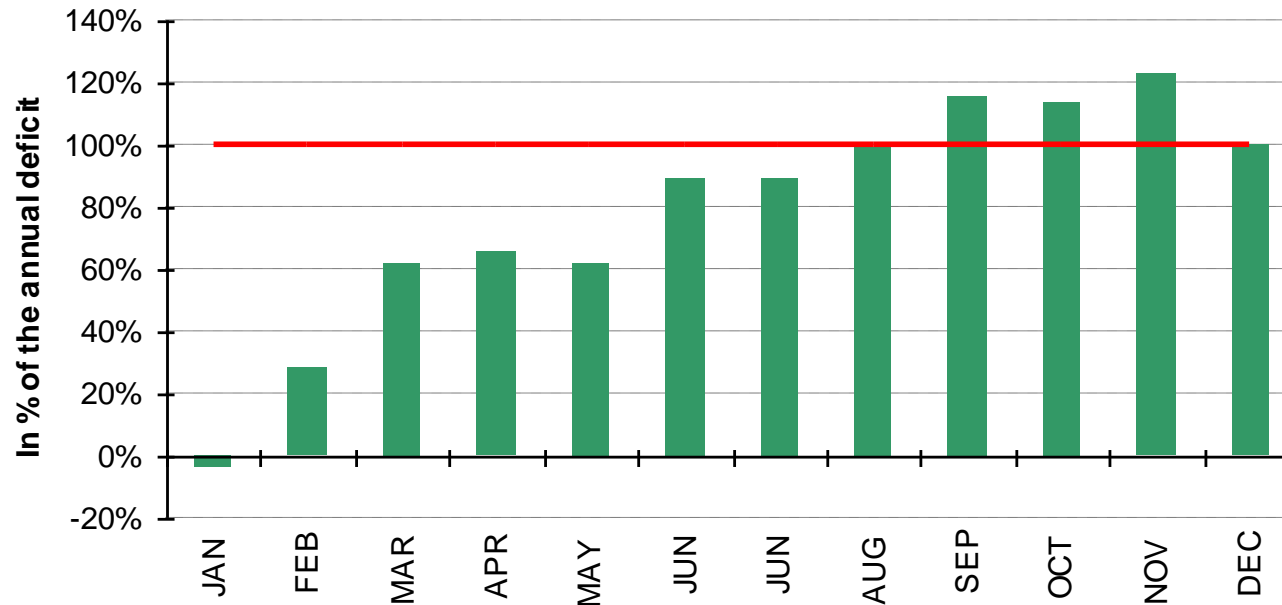
Liquidity Management Instruments

- Active adjustment of the volume of 3-month Discount Treasury Bills at auctions
- Short-term (so-called liquidity) T-Bills
- Active and passive repo operations
- Regular buyback auctions
- Exchange (switch) auctions
- Temporary use of stand-by and other loan facilities
- Foreign currency denominated assets are taken into account if they are converted (e.g. by using swaps) into HUF
- Timing of FX bond issues could also be used for strengthening the liquidity position

Challenges: Intra-Year Seasonality

- Expenditures in the first half of the year (e.g. agricultural subsidies, tax refunds etc.)
- Large tax payments are scheduled for Q4
- Bond issuance takes place at a steady pace according to an issuance calendar

Seasonality of the Hungarian Budget
2009



Managing Intra-Year Seasonality

- Increased T-bill issuance in H1, that mature at the end of the year
- 3 month T-Bills: Smaller amounts offered towards the end of the year
- Timing of FX-denominated bonds (also depending on market demand)
- Negative net issuance in the 4th quarter of the year

Issuance plan for Q4 2013

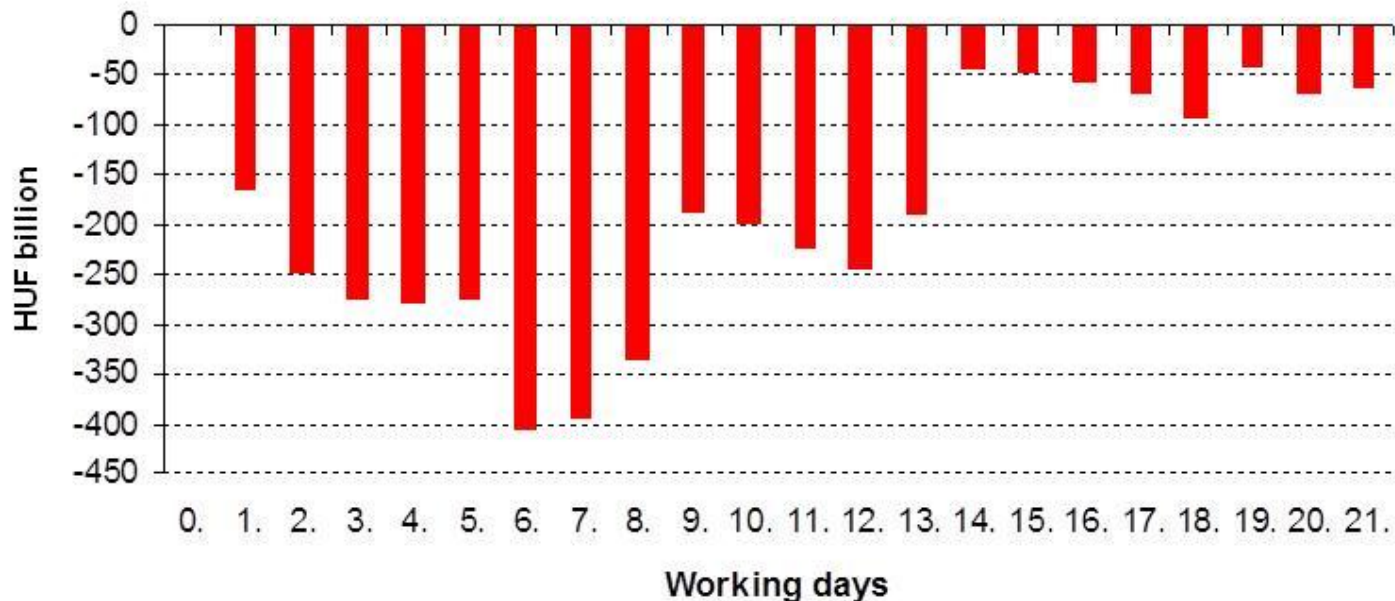
HUF Million

Securities	Maturity	Issuance	Net issuance
T-Bills	934 999	829 999	-105 000
<i>of which 3 month</i>	674 999	579 999	-95 000
<i>12 month</i>	261 000	250 000	-11 000
Retail paper (1 year KKJ)	132 702	177 174	44 472
Government bonds	622 993	368 608	-254 385
TOTAL	1 690 694	1 375 781	-314 913

Challenges: Intra-Month Seasonality

- Public sector salaries and pensions are paid in the first half of the month
- Tax is paid after the 20th of the month
- Tax refund is paid in 45 days (usually at the beginning of the second month following the month of payment)

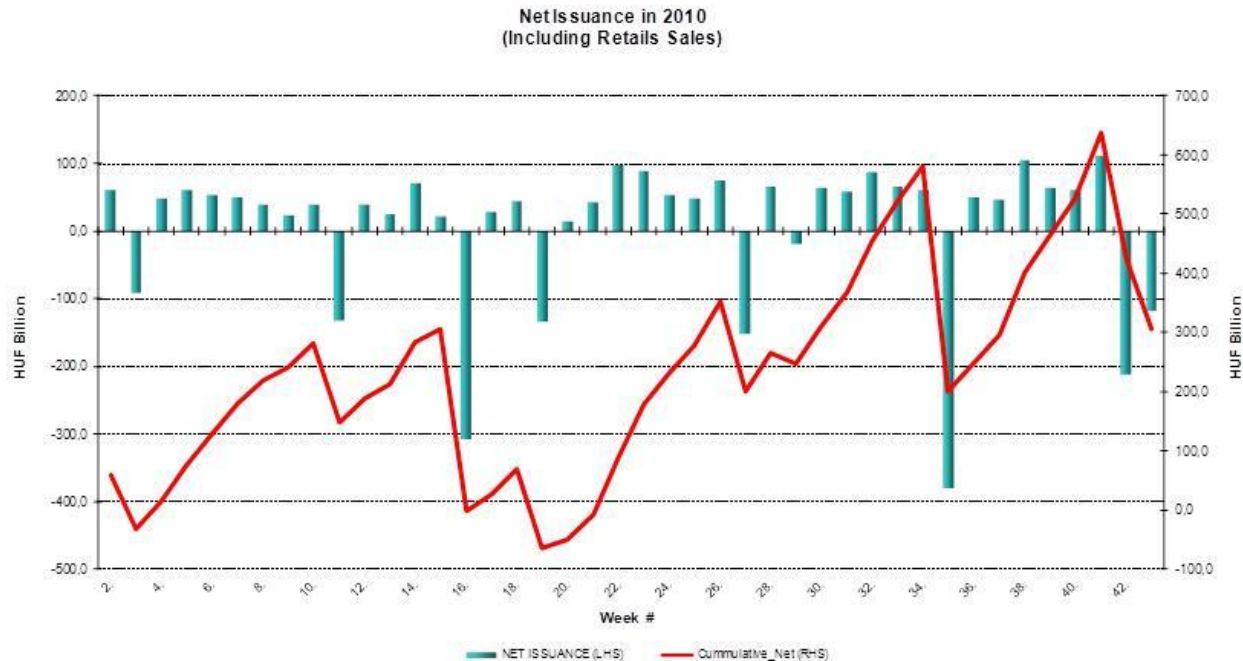
Typical Intra-Month Seasonality of the Budget
(Cumulative figures)



Managing Intra-Month Seasonality

- Avoid extraordinary expenditure in the first half of the month
- Real improvement depends on the ability of the MNE and the HST in cooperation with budgetary institutions to schedule payments with respect to expected income
- The problem of deadline or periods available for payment
- This situation may cause extra costs for the budget
- Instruments used for management:
 - ✓ Passive and active repo operations (O/N, T/N, S/N, S/W)
 - ✓ Liquidity T-Bill issuance (if needed)
 - ✓ FX assets swapped temporarily into HUF (if needed)

Managing Roll-over Risks



- Through buybacks and exchange auctions ÁKK succeeded to bring the size of the maturing bonds to 300-350 billion
- Liquidity T-Bill issuance: – reopening of formerly issued T-Bill series with a remaining maturity of 5-6 weeks
- Passive repo operations
- Use of cash buffers on the TSA (if needed)
- FX assets swapped temporarily into HUF (if needed)

Conclusions

- We find it useful to have debt and liquidity management integrated into one entity, though efficiency of the liquidity management relies heavily on the exactness of third party forecasts
- Public debt managers need substantial cash buffers (the optimal size may vary from country to country). These may be kept
 - ✓ at the central bank (TSA), or
 - ✓ at least partially placed with market participants, influencing the general liquidity position of the local interbank market (but this is not the objective!)
- Cash buffers should be supplemented by regular liquidity management instruments (I would not call them emergency funding) like stand-by facilities and issuance of liquidity T-Bills
- Given the market requirement to maintain large benchmark bond series by the public debt manager, prudent refinancing risk management may be promoted by a number of active tools (e.g. buybacks, exchange auctions)
- The wider the choice of instruments the easier this task may be

Thank you for your attention

More information:

www.akk.hu