DEBT MANAGEMENT OUTLOOK 2020

GOVERNMENT DEBT MANAGEMENT AGENCY PTE LTD.

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BUDAPEST, December 2019

Contents

1. Net financing requirements in 2020

According to the Act on the budget for the year 2020, the deficit of the central government calculated on a ***cash-flow basis*** is planned at **HUF 367 billion**, equaling to 0.8% of the GDP.

The total cash-flow based net financing requirement for the year 2020 is equal to the deficit of the central government and other items, such as the balance of EU transfers. These other financing needs are considered items that are to be handled by liquidity management (e.g. with discount T-bills).

2. Government debt redemptions

The total amount of government debt redemptions and pre-financing in 2020 is planned at **HUF 6,938 billion,** 14.2% of GDP, 13% less than planned in 2019.[1]

	2019 plan (HUF bn)	2019 estimate (HUF bn)	2020 plan (HUF bn)	2020 plan (EUR bn)
HUF debt maturities	6,823	7,647	5,524	16.6
T-bonds	1,204	1,272	1,058	3.2
Retail securities	4,355	5,124	3,768	11.3
Discount T-bills	1,250	1,237	651	2.0
HUF loans	14	14	47	0.1
FX debt redemptions	666	630	741	2.2
International bonds	423	371	534	1.6
Domestic bonds	207	214	131	0.4
IFI and other loans	36	45	76	0.2
Total maturities	7,489	8,277	6,265	18.8
T-bond buy-backs	250	718	250	0.8
Switch auctions	250	828	423	1.3
FX bond buy-backs		270		
Total pre-financing	500	1,816	673	2.1
Total redemptions including pre-financing	7,989	10,093	6,938	20.9

The redemptions of domestic currency debt will amount to **HUF 5,524 billion,** 19 % less than planned in 2019**.** Domestic currency bond redemptions will amount to HUF 1,058 billion (HUF 146 billion less than originally planned in 2019), discount T-bill redemptions will amount to HUF 651 billion (almost

[1] ÁKK provides gross issuance and redemption data according to the methodology recommended by OECD, which takes redemptions of short-term securities - typically Treasury bills - only once into account to avoid multiple counting.

half of the 2019 plan); the sum of these marketable domestic debt redemptions of HUF 1,709 billion corresponds to 3.5% of GDP. In order to reduce future refinancing risk, ÁKK plans to buy back (HUF 423 billion) and switch (HUF 250 billion) bonds maturing in 2021 or later (pre-financing). Large part of the domestic debt redemptions is the redemption of retail securities, which decreases significantly compared to 2019, but the retail sector usually reinvests its maturing holdings and even increases the outstanding stock of retail securities.

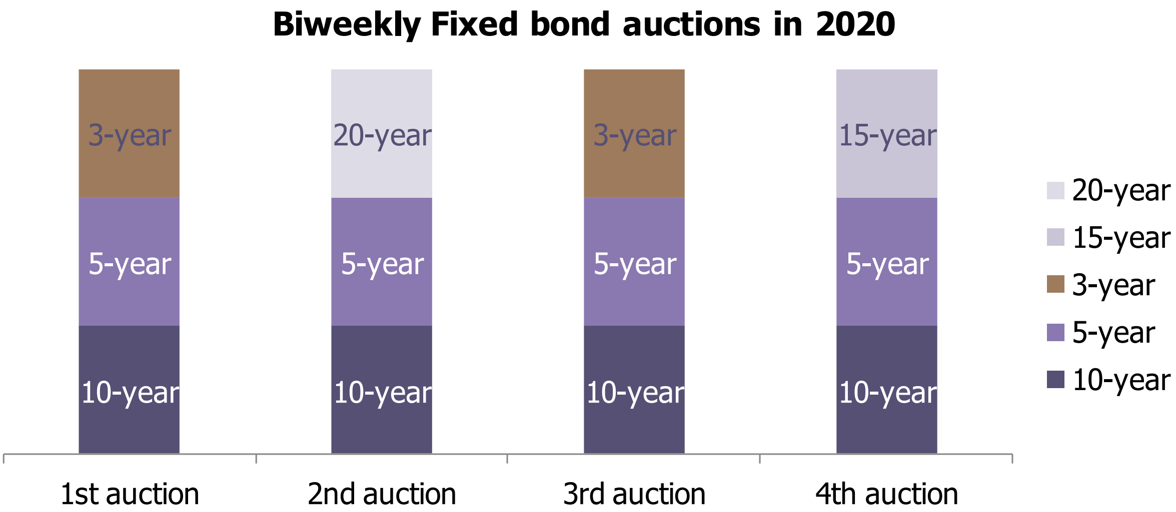
Foreign currency debt redemptions will total **EUR 2.2 billion** (HUF 741 billion) – a bit higher than the original maturities in 2019 –, out of which international bond redemptions will amount to EUR 1.6 billion, domestic bond redemptions will amount to EUR 0.4, while the redemption of IFI and other loans will amount to EUR 0.2 billion.

3. Gross issuance

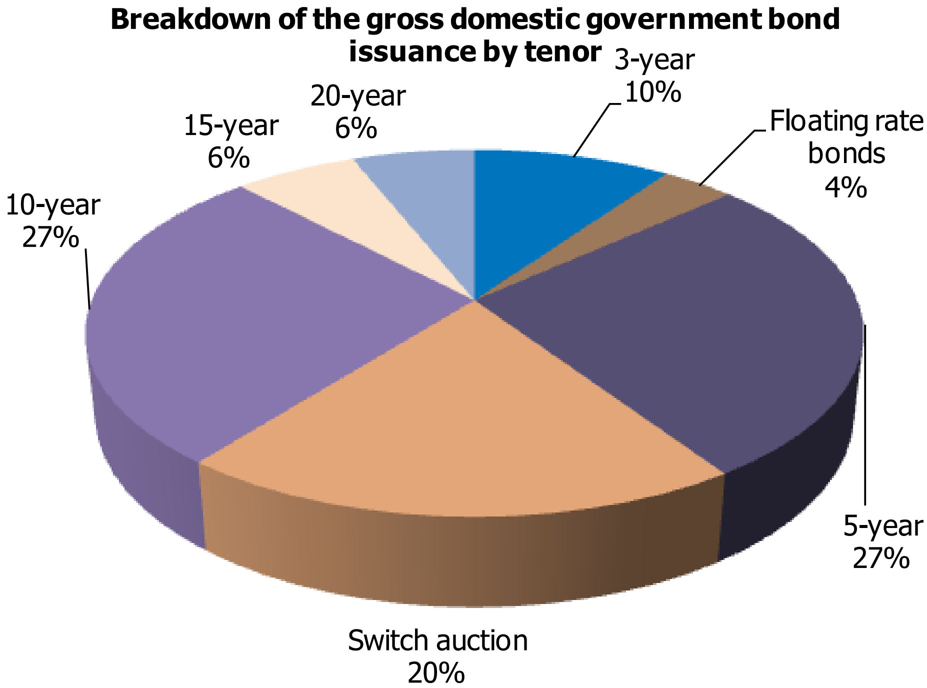
Total gross issuance is planned at **HUF 7,335 billion** in 2020, 21% less than planned in 2019 and 33% (or HUF 3,556 billion) less than the current forecast for 2019. 95.5 per cent of the total gross issuance (**HUF 7,003 billion**) will be in domestic currency and only 4.5 per cent (**HUF 332 billion** or EUR 1 billion) will be in foreign currencies.

	2019 plan (HUF bn)	2019 estimate (HUF bn)	2020 plan (HUF bn)	2020 plan (EUR bn)
Domestic issuance	9,217	10,748	7,003	21.1
T-bonds	2,650	3,404	2,017	6.1
out of which via switch auction	250	757	400	1.2
Retail securities	5,155	6,638	4,168	12.6
Discount T-bills	1,250	651	651	2.0
HUF loans	162	55	166	0.5
FX issuance	32	143	332	1.0
International Bonds	0	0	266	0.8
Domestic Bonds	32	90	66	0.2
IFIs loans	0	53	0	0.0
Grand total	9,249	10,891	7,335	22.1

HUF 1,617 billion worth of domestic currency government bonds will be offered at auctions, which is substantially lower than in 2019, while another HUF 400 billion of bonds is expected to be sold at switch auctions. The breakdown by tenor is expected to move towards longer terms – subject to actual auction demand –, meaning that the share of the shortest, 3-year T-bond will decrease significantly. ÁKK will introduce a new, 20-year benchmark bond series in January 2020. To support the lengthening of the average term to maturity of the debt ÁKK will adjust the auction schedule. Similar to previous years, fixed rate bond auctions will be held every second week, however, the 5-year and 10-year bonds will be offered at every auction and the frequency of 3-year bond auctions will be halved. At every second auction the 15-year bond and the new 20-year bond will be offered alternatingly.



In 2020 the planned issuance of HUF-denominated government bonds are as follows:



ÁKK will launch a new 3-year and 20-year fixed bond series during 2020, while for other tenors the currently on-the-run bonds will be offered. A new, longer term floating rate bond will be issued in 2020, auctioned once a month. The issuance calendar contains only the dates of bond auctions. ÁKK may decide on the actual bond series and the amounts offered after consultations with Primary Dealers.

ÁKK will hold both bond-buyback and exchange (switch) auctions – similar to the practice followed recently – in order to support a balanced government bond issuance pattern as well as to manage the maturity profile and to reduce the refinancing risk of the bond portfolio by extending its average term-to-maturity. ÁKK's exchange auctions will also support the increasing demand for longer term and lower demand for shorter term government bonds of investors who will follow the new HMAX government bond benchmark index, to be introduced at the beginning of 2020.

ÁKK intends to finance large part of the foreign currency maturities from the domestic market. The financing plan contains EUR 1 billion equivalent of foreign currency debt issuance in 2020. ÁKK will explore Green bond issuance in Japanese Yen and/or Chinese Renminbi subject to market conditions and appropriate approvals, issuance of these instruments is planned at EUR 800 million. The issuance of the domestic FX bond (Premium Euro Hungarian Government Bond) is expected to provide funding of EUR 200 million. ÁKK plans to draw down IFI project financing loans (EUR 500 million equivalent) in the domestic currency. Depending on the budget's liquidity position and market conditions ÁKK may continue to follow past years' strategies to actively manage the FX debt stock.

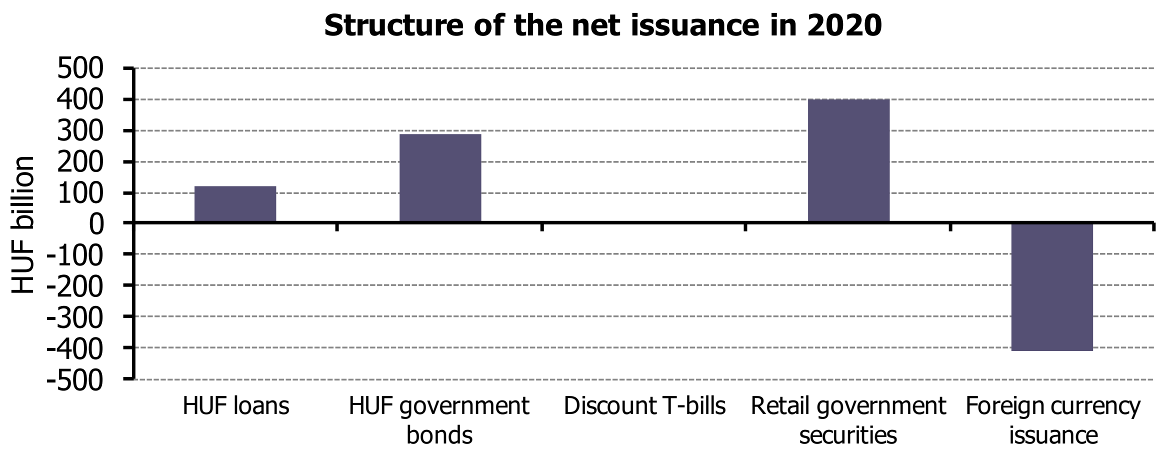
4. Net issuance

Net government debt issuance is planned in an amount of **HUF 397 billion**, one-third of the originally planned net issuance of HUF 1,260 billion in 2019. Out of this net domestic debt issuance will reach **HUF 806 billion** (58% less than the HUF 1,894planned in 2019), and net foreign currency borrowing will amount to **HUF -409 billion** (EUR -1.2 billion).

ÁKK will closely monitor the market and will decide on the amounts accepted at auctions according to bids. Net issuance covers the deficit of the central government and increases the liquidity reserves of the government. If the favorable liquidity conditions remain in 2020, ÁKK will increase the pro-active market operations to reduce the refinancing risk of coming years.

Out of the net domestic government securities issuance (HUF 806 billion) net bond issuance will be HUF 286 billion. The stock of retail government securities is expected to increase by HUF 400 billion as a result of two contrary processes: the outstanding stock of households is expected to grow by HUF 1,200 billion, while significant (HUF 800 billion) redemptions of retail securities held by non-household sectors will take place in 2020. The dynamic growth of households' demand is supported by the successful Hungarian Government Security Plus bond and by the introduction of a new, longer term retail security in 2020. According to the plan the stock of discount T-bills will not change in 2020, however, their outstanding volume can be increased rapidly if needed for liquidity management purposes. Net issuance of HUF loans will be HUF 120 billion.

As the total foreign currency redemption will amount to EUR 2.2 billion and the gross foreign currency issuance is planned at only EUR 1.0 billion, thus **the net foreign currency issuance is expected to amount to EUR -1.2 billion in 2020**. This amount may be higher in case of pre-financing by buying back bonds that have a short remaining term-to-maturity.



5. Debt management strategy and benchmarks

ÁKK's mission is to finance the central government at the lowest costs in the long run, taking account of risks. In accordance with the economic policy of the government ÁKK has set four main objectives:

1. According to the fundamental law of Hungary if the debt to GDP ratio is higher than 50 percent, only such a budget can be approved, which leads to the reduction of the debt ratio year by year. **The primary objective of debt management is to support the reduction of the debt ratio** accordingly.

2. One of the main factors that led to the vulnerability of Hungary in the past is that the higher part of the government debt had been financed from abroad. Domestic savings and the domestic financing of the debt can support macroeconomic stability in the long term. Thus the second objective of ÁKK is to broaden the domestic investor base by funding large part of the deficit via **retail financing**.

3. The decreasing debt ratio and the increasing domestic financing enable to **decrease further the share of foreign currency debt** within the total debt, which is the third objective of ÁKK.

4. From 2020 ÁKK introduces the objective to **increase the average term-to-maturity (ATM) of the debt**. In international comparison the average term-to-maturity of the Hungarian debt is low, the share of maturing debt within one year is relatively high. ÁKK makes efforts to improve the maturity structure of the debt, reduce the refinancing risk by increasing the ATM of primarily the domestic currency debt.

In recent years the debt to GDP ratio and the share of FX debt decreased significantly due to the prudent fiscal policy and the pursued debt management strategy. The share of FX debt is already favorable in regional comparison, acknowledged also by the major credit rating agencies, which upgraded Hungary to the investment-grade category in 2016 and upgraded Hungary's sovereign debt rating to BBB in 2019 (S&P and Fitch).

The mission of Hungary's government debt management is quantified by setting portfolio benchmarks, which are mainly based on a general optimal portfolio model taking into account both costs and risks. ÁKK has determined the following benchmark targets for government debt management in 2020:

- ***Share of foreign currency debt:*** The share of the foreign currency denominated debt within the total central government debt should be in the 10-20% range. The decreasing share of foreign currency debt is achieved by covering the net financing needs and the large part of the maturing FX debt with financing in domestic currency.

- ***Currency mix of the foreign currency denominated debt:*** In order to mitigate cross-currency exchange rate risk, foreign currency obligations after swaps should be 100% in EUR, allowing for a 5% deviation from this target.

- ***Fixed / floater composition:*** Within the **HUF debt**, the share of the fixed rate elements should be in the range of 60-80%, and that of the floating rate debt, which includes all short-term debt, between 20% and 40%. Within the **foreign currency denominated debt**, the share of the fixed rate elements should be in the same range of 60-80%, and that of floating rate debt between 20% and 40%.

- ***Average Time to Re-fixing (ATR):*** ÁKK measures the re-pricing (interest rate) risk with the common ATR indicator. In order to keep an acceptable level of refinancing risk, the ATR of the HUF debt portfolio is targeted to be above 3.5 years. In case of adequate demand, ÁKK can increase the ATR, without an upper limit.

- ***Average Term to Maturity (ATM):*** ÁKK introduces a new benchmark in 2020 to measure the refinancing risk of the debt as well. To reduce the refinancing risk the average term to maturity of the domestic debt should be above 4 years. In case of adequate demand, ÁKK can increase the ATM of the domestic currency debt portfolio.

- ***Liquidity:*** In order to maintain the continuously safe financing of the budget, a minimum target balance of the Treasury Single Account has been determined and ÁKK's objective is to keep the end-of-day actual balance over this level.

In the case of the first six benchmark values ÁKK takes into account their 3-month moving average values, to avoid unnecessary reaction to one-off or temporary market movements that actually would not need a response in the medium or longer term.

To maintain a safe level of liquidity reserves and access to several financing channels also remain the emphasized goals of financing in 2020. Beside keeping a liquidity buffer equaling to at least 6-weeks' financing requirements, repos and FX deposits are also available for liquidity management. This ensures that financing is secured even in the case of a few uncovered auctions. Successful bond buy-backs and switch auctions also increase financing safety by substantially decreasing the volume of domestic currency debt maturities.

6. Further information

This Debt Management Outlook publication was compiled based on information available in the middle of December 2019. Thus the projected figures for 2020 may change according to the outturn of the financing needs and debt issuances. Even though the structure of financing may change compared to the plans, the issuance calendar is fixed (see next chapter), and ÁKK will not change the set of instruments used, its strategic objectives and its strategic behavior in the markets either.

ÁKK's website (www.akk.hu, www.gdma.hu) and its regular publications and reports (monthly and quarterly publications; monthly report on debt transactions) provide regularly updated information on the financing needs, the debt transactions and the government debt. ÁKK also discloses until the 15th of each month the detailed domestic market issuance plan for the next 3 months, which shows the amounts to be issued for each tenor.

7. Issuance calendar

Issuance calendar of government bonds in 2020

Fixed rate government bonds

Date of auction	Date of settlement
02.01.2020	08.01.2020
16.01.2020	22.01.2020
30.01.2020	05.02.2020
13.02.2020	19.02.2020
27.02.2020	04.03.2020
12.03.2020	18.03.2020
26.03.2020	01.04.2020
09.04.2020	15.04.2020
23.04.2020	29.04.2020
07.05.2020	13.05.2020
21.05.2020	27.05.2020
04.06.2020	10.06.2020
18.06.2020	24.06.2020
02.07.2020	08.07.2020
16.07.2020	22.07.2020
30.07.2020	05.08.2020
13.08.2020	19.08.2020
27.08.2020	02.09.2020
10.09.2020	16.09.2020
24.09.2020	30.09.2020
08.10.2020	14.10.2020
22.10.2020	28.10.2020
05.11.2020	11.11.2020
19.11.2020	25.11.2020
03.12.2020	09.12.2020

Floating rate government bonds

Date of auction	Date of settlement
09.01.2020	15.01.2020
06.02.2020	12.02.2020
05.03.2020	11.03.2020
02.04.2020	08.04.2020
30.04.2020	06.05.2020
28.05.2020	03.06.2020
09.07.2020	15.07.2020
06.08.2020	12.08.2020
03.09.2020	09.09.2020
01.10.2020	07.10.2020
29.10.2020	04.11.2020
26.11.2020	02.12.2020

Issuance calendar of discount treasury bills in 2020

12-month discount T-bills

Code	Date of auction	Date of settlement	Date of maturity
D201223	09.01.2020	15.01.2020	23.12.2020
D201223	23.01.2020	29.01.2020	23.12.2020
D201223	06.02.2020	12.02.2020	23.12.2020
D210224	20.02.2020	26.02.2020	24.02.2021
D210224	05.03.2020	11.03.2020	24.02.2021
D210224	19.03.2020	25.03.2020	24.02.2021
D210224	02.04.2020	08.04.2020	24.02.2021
D210421	16.04.2020	22.04.2020	21.04.2021
D210421	30.04.2020	06.05.2020	21.04.2021
D210421	14.05.2020	20.05.2020	21.04.2021
D210421	28.05.2020	03.06.2020	21.04.2021
D210421	11.06.2020	17.06.2020	21.04.2021
D210630	25.06.2020	01.07.2020	30.06.2021
D210630	09.07.2020	15.07.2020	30.06.2021
D210630	23.07.2020	29.07.2020	30.06.2021
D210630	06.08.2020	12.08.2020	30.06.2021
D210825	20.08.2020	26.08.2020	25.08.2021
D210825	03.09.2020	09.09.2020	25.08.2021
D210825	17.09.2020	23.09.2020	25.08.2021
D210825	01.10.2020	07.10.2020	25.08.2021
D211020	15.10.2020	21.10.2020	20.10.2021
D211020	29.10.2020	04.11.2020	20.10.2021
D211020	12.11.2020	18.11.2020	20.10.2021
D211020	26.11.2020	02.12.2020	20.10.2021
D211020	10.12.2020	16.12.2020	20.10.2021
D211229	23.12.2020	30.12.2020	29.12.2021

3-month discount T-bills are auctioned every Tuesday, settlement is on the Wednesday of the following week.

Liquidity discount T-bills are auctioned upon decision of the Issuer, generally on Monday with settlement on the following Wednesday.