

# HUNGARY

## SECURITIES

### *SUMMARY*

The Hungarian securities market has grown dramatically since its return to operation in 1990, and even more significantly since 1994. The Budapest Stock Exchange (BSE) has expanded from listing one security in 1990 to 149 listings in 1997. The Budapest Commodity Exchange (BCE) allows trading in eight currencies and two interest rates, as well as futures contracts on grains and livestock.

The period from late 1996 to present has been one of spectacular increase in activity, especially on the stock exchange, both in volume and in value. Volatility has also been high. Share prices have fluctuated sharply due to financial crises in Asia and Russia as well as uncertainty surrounding Hungary's national elections in May 1998. The majority of companies listed on the BSE have seen strong earnings growth and stock price appreciation. This, coupled with Hungary's strong economic fundamentals, has been both a boon and a curse for the exchange. Foreign and domestic investors have poured substantial sums into listed equities and bonds in times of calm, but appear to have liquidated their holdings of BSE shares to shore up balance sheets weakened by losses in other emerging markets.

Market regulation, while essentially well-structured, lacks some necessary investigation and enforcement powers. To date there have been no reported instances of major investor losses because of inadequate capital market supervision.

Foreign firms enjoy discrimination-free access to brokerage licenses and over half of the existing brokerages have some foreign ownership. Participation by U.S. firms is small, while Western European banks have established numerous trading subsidiaries with privileges on the BSE.

### *DESCRIPTION OF THE MARKET*

Hungary's two exchanges, the BSE and the BCE, trade a range of financial instruments and futures contracts. The BSE lists stocks, bonds, investment trusts, and compensation coupons. The BCE lists futures contracts on grains, livestock, currencies, and interest rates.

#### **The Budapest Stock Exchange**

The BSE resumed trading on June 21, 1990, becoming the first stock exchange to reopen in the former Communist states in Central and Eastern Europe. Only one security was listed initially. By the end of 1990, there were six securities. At the end of 1997, 149 securities were listed. In

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December 1994, total capitalization was HUF 883.8 billion (US\$8.0 billion); at the end of 1997 it had reached HUF 5,115 billion (US\$25.1 billion).

As shown in the following table, the number of listed securities is roughly split between bonds and T-bills, on the one hand, and equities and investment funds, on the other. In terms of value, however, bonds and T-bills dominate, accounting for 77 percent of the nominal value of listed securities. Compensation coupons – given to Hungarians to recompense property lost under Communist or World War II fascist regimes – accounted for only 5.7 percent of nominal value, down from 14.1 percent in 1994. Equities accounted for 16.1 percent, up from 9.3 percent in 1994. There were 20 investment funds (mutual funds), accounting for just 1.1 percent of nominal value.

	<b>Budapest Stock Exchange</b>			
	end-of-year			
	1994	1995	1996	1997
Number of members	51	56	57	63
<i>of which:</i>				
<i>Brokerage firms</i>	50	55	56	62
<i>Banks</i>	1	1	1	1*
Number of listed securities	120	166	167	149
<i>of which:</i>				
<i>Equities</i>	40	42	45	49
<i>Bonds</i>	28	37	38	35
<i>T-bills</i>	31	50	50	44
<i>Investment funds</i>	20	36	33	20
<i>Compensation notes</i>	1	1	1	1

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	1994	1995	1996	1997
Nominal value of securities admitted (HUF billions)	856.3	1,217.8	1,833.6	2,467.1
<i>of which:</i>				
<i>Equities</i>	79.8	211.7	286.1	398.2
<i>Bonds</i>	375.8	420.0	617.4	940.5
<i>T-bills</i>	256.6	413.5	750.1	961.7
<i>Investment funds</i>	23.8	43.0	40.4	27.0
<i>Compensation notes</i>	120.3	129.7	139.7	139.7

\*National Bank of Hungary

Source: BSE

Between January 1, 1996 and June 30, 1997, record trading volume and a steep upturn in prices on the spot market made the BSE the leading exchange in East and Central Europe. Due to steadily increasing domestic and foreign interest in Hungarian shares, the BSE index gained 133.5 percent in 1996 in US\$ terms, outperforming all other emerging markets. As shown in the table below, in 1997 the spot market turnover of the BSE exceeded HUF 6,736 billion (US\$36.1 billion), of which 42.7 percent was attributable to the corporate equities market. This is up from 27 percent in 1994. The number of trades has exploded, indicating significant small investor participation in the market.

<b>Budapest Stock Exchange</b> (HUF billions)				
	1994	1995	1996	1997
Turnover (market value)	211.23	253.18	1,145.44	6,736.31
<i>of which:</i>				
<i>Equities</i>	57.11	87.27	490.53	2,872.71
<i>Bonds</i>	53.90	77.21	418.78	1,998.57
<i>T-bills</i>	81.22	81.11	206.33	1,817.74
<i>Investment funds</i>	0.26	3.43	8.88	2.33
<i>Compensation notes</i>	18.74	4.16	20.93	44.97

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	1994	1995	1996	1997
Number of transactions	70,744	71,240	170,956	504,879
Average daily number of transactions	281	286	689	2,044
Average daily turnover	838.2	1,016.8	4,618.7	27,272.5
Turnover/transaction	3.0	3.6	6.7	13.3

Source: Budapest Stock Exchange

In October 1993, the BSE, together with the National Bank of Hungary and the BCE, established a Central Clearing House and Depository (KELER). The clearing house was designed to provide timely settlement of securities market and derivatives transactions completed in Hungary, and provides safekeeping for securities primarily for financial institutions.

The BSE has been extremely volatile since June 1998 due to a combination of factors. Post-election concerns over the possible economic policies of the incoming government caused a strong drop in share prices in June. Prices stabilized in late June and July, only to tumble again in August from the combined impact of the worsening Asian financial crisis and the economic turmoil in Russia, despite strong Hungarian fundamentals and favorable price/earnings ratios for most listed firms. The sell-off appears to have been driven by investors with extensive holdings in riskier markets, taking advantage of the BSE's good liquidity to shore up their financial positions. (The BSE's good liquidity has been attributed to: (1) efficient clearing operations; and (2) the strong reputations and past performance of listed companies, so that even in a bear market sellers have been able to find buyers.)

The BSE has recently decided to adjust its fluctuation limits on the spot market. Shares in the BUX basket (the share index of the BSE) will be suspended for 10 minutes if prices fluctuate more than 8 percent and trading will be suspended for the remainder of the session if the price change reaches 15 percent. These new fluctuation limits took effect in August 1998. The 10 percent and 20 percent rules will remain in effect for all other shares.

Pension reform is expected to bring significant new investment funds to the BSE. This is especially true of the pension system's "second pillar" – obligatory contributions to privately managed, government regulated pension funds. These funds will be able to invest worker contributions in registered securities. Contributions are obligatory only for new entrants to the job market, beginning in 1998. The response to these funds has been overwhelming. Over 25 percent of the total employed workforce had joined second pillar funds by June 1998.

## **The Budapest Commodity Exchange**

The BCE was established on August 15, 1989 as the Produce Exchange Co., and began trading grains futures on October 25, 1989, six months before the first democratic election in Hungary. The BCE was the first operational futures market in the region. Established as a private commodity exchange modeled after American commodity exchanges, the BCE is a non-profit, self-governing organization. In 1990, the BCE changed its name from the Produce Exchange to its current name. Present ownership is made up of banks, foreign trade companies, brokers, grain traders, and meat processors.

BCE floor rules require an exchange seat in each market for which privileges are desired: grains, livestock, and financial (includes currencies and interest rates). The maximum number of members in each section is 50. The grains and livestock sections are at full capacity, but the financial section still has 32 places available. As with the BSE, payment and clearance is effected through KELER. Earlier BCE rules had provided membership for any company or individual, Hungarian or foreign, meeting certain financial and other criteria. Current legislation provides for closer regulation of traders by limiting membership to companies registered under Hungarian law.

The BCE offers two basic types of trades: spot and futures trades. Spot contracts are, however, only permitted in the grains and livestock sections. The proportion of spot trades in the total turnover of the BCE is becoming marginal. The main type of trade on the exchange floor is the buying and selling of futures. Turnover of these standardized contracts is increasing dynamically, mainly as a result of rising interest in currency futures and other financial instruments. The currency section is significantly stronger than the other two sections. It now accounts for 97 percent of the BCE market share. Trading is done through the open-outcry method.

Foreign currency futures were introduced in March 16, 1993, with the Hungarian forint contracts written against deutschmarks and U.S. dollars to allow hedging of currency risk. In January 1994, a Japanese yen contract was added. To date there are eight currencies and two interest rates available for trading, including: the U.S. dollar, the deutschmark, the yen, the ecu, the pound sterling, the lira, the Swiss franc, the Czech koruna, and one-month and three-month BUBOR interest rates.

## **Regulatory Structure**

Securities trading regulations are administered and enforced by the State Banking and Capital Markets Supervision (APTF). The APTF also regulates futures trading. Although modeled after the U.S. Securities and Exchange Commission, the APTF has fewer enforcement powers. The APTF has full legal rights to oversee securities contracts and registration and to access files of broker companies. It must rely on the police, however, to investigate suspected violations.

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### *U.S. PRESENCE IN THE MARKET*

There are no prohibitions against foreign company ownership in brokerages engaged in either the stock or commodity markets. U.S. presence is limited to five companies (out of 62), but includes large firms such as Citibank Securities Co. Major Western European banks have also established trading subsidiaries with privileges on the BSE.

### *TREATMENT OF U.S. FINANCIAL INSTITUTIONS*

Foreign firms have discrimination-free access to brokerage licenses and over half of the existing brokerages have some foreign ownership. Trading rights are limited to firms specifically established to engage in securities transactions. Banks and other financial institutions must set up dedicated, separate subsidiaries in order to trade. Brokerage licenses are issued on a non-discriminatory basis, available to those Hungarian citizens and foreigners who fulfill the necessary criteria. The criteria are:

1. The brokerage company must be a company registered in Hungary;
2. The company must meet minimum capital requirements, depending on the license sought;
3. Managers and brokers must pass an examination on Hungarian securities law in the Hungarian language, given by the APTF, and must present evidence of two years' experience in securities transactions.

Hungary's GATS schedule of commitments is one of the most liberal offered during the negotiations. To date, it has been fully implemented, both *de jure* and *de facto*.

#### **Exchange Rates Used:**

1994 end of period	110.7 HUF/US\$
1997 end of period	203.5 HUF/US\$
1997 period average	186.8 HUF/US\$