CONSIDERATIONS BEHIND THE LAUNCH OF THE BOND FUNDING FOR GROWTH SCHEME (BGS) AND MAIN FEATURES OF THE PROGRAMME

2019

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Summary

Following the outbreak of the financial and economic crisis in 2008, in Hungary the loans outstanding of corporations – and particularly of SMEs – recorded an extreme fall even by international standards. As a result of the roughly 5 percent annual decline for almost 5 years, by the beginning of 2013, corporate loans outstanding shrank to 75 percent of the pre-crisis level. The economy faced the phenomenon of a 'credit crunch', which required intervention by the central bank. Since bank loans are a key form of financing in Hungary, in recent years the central bank's measures focused on mitigating SME credit market disturbances by fostering the supply of available funds.

In June 2013, the MNB launched the Funding for Growth Scheme (FGS) with the aim of restoring the credit channel in the monetary transmission mechanism. The scheme contributed to reversing the downward trend in corporate – and particularly SME – lending, and in 2018, the annual growth rate of SME lending was already around 12 percent. Considering that growth in the corporate loans outstanding by 1 percentage point is typically accompanied by GDP growth of 0.25 percentage point, today economic growth already relies on bank loans, i.e. it is realised from internal funds. The volume of corporate lending reached an adequate level, but its structure is not sound enough. With the purpose of increasing the ratio of long-term, fixed-rate loans, at the beginning of 2019, the MNB launched the Funding for Growth Scheme Fix (FGS fix) with a facility amount of HUF 1,000 billion.

As a result of the turnaround in lending in recent years, the volume of lending is now adequate. However, the diversification of financing has not yet been realised: while the value of the bank loans of non-financial corporations as a percentage of GDP exceeds 17 percent, their bond portfolio amounted to only about 1.5 percent at the end of 2018. This value lags far behind the average of both the EU member states and of the CEE countries.

Placing corporate fund raising on multiple pillars has numerous advantages. An advanced corporate bond market can generate competition for bank loans, as a result of which companies' funding costs may decrease. Furthermore, a liquid bond market contributes to improving the efficiency of monetary policy transmission, while healthy competition between markets providing funds for companies may render the central bank's interest rate decisions more effective. In addition, a sufficiently liquid, advanced bond market may increase financial stability and also mitigate the effects of a potential economic crisis.

To increase the liquidity of the corporate bond market, the MNB – supplementing its present set of unconventional monetary policy instruments and the FGS fix – will launch the Bond Funding for Growth Scheme (BGS) on 1 July 2019. Within the scope of the scheme, for a facility amount of HUF 300 billion the central bank will purchase bonds with good ratings issued by non-financial corporations as well as securities backed by corporate loans.

By increasing the liquidity of the bond market, the MNB intends to improve the efficiency of monetary policy transmission and to also encourage economic actors to rely on this type of financing, in addition to bank loans, to a sufficient proportion. Bond issuance may represent an alternative to bank financing primarily for larger companies, but as the market becomes more liquid, credit claims on SMEs may also later appear in securitised form, which may result in a further improvement in financing conditions in the SME sector.

The scheme has no effect on the monetary policy conditions, it is neutral in terms of the present stance of the interest policy. The MNB intends to absorb (sterilise) the excess volume of funds resulting from the purchases under the BGS – fitting into the effective monetary policy framework – with the preferential deposit facility, within the scope of which eligible credit institutions may place deposits with the central bank at the base rate.

The purpose, conditions and operation of BGS heavily relies on the European Central Bank's (ECB) corporate sector purchase programme (CSPP). Within the scope of the CSPP, between June 2016 and December 2018, the ECB purchased bonds issued by euro area companies, thereby contributing to the improvement in the efficiency of monetary policy transmission. The ECB will not increase the stock of the purchased portfolio in the future, but will use the principal repayments for the maintenance thereof.

Key conditions of the Bond Funding for Growth Scheme of the Magyar Nemzeti Bank	
Total amount	HUF 300 bn (0.7 percent of GDP)
Start of the purchases	1 July 2019
Issuers of the bonds to be purchased	domestic non-financial corporations
Denomination of the bonds to be purchased	HUF
Original maturity of the bonds to be purchased	minimum 3 years, maximum 10 years
Credit rating of the bonds to be purchased	at least B+
Proportion of MNB's purchase per bond series	max. 70 per cent
Maximum exposure of the MNB per corporate group	HUF 20 bn
Minimum volume per issuance	HUF 1 bn
Sterilisation of the excess liquidity arising from the purchases	by the preferential deposit facility

1 Role of the corporate bond market in the economy

For companies,[1] **fund raising via the bond market – in addition to taking bank loans – represents an alternative source of finance.** Companies use a variety of resources to finance their long-term investments and daily business activity: in addition to shareholders' equity, financing may be provided by utilising debt liabilities, i.e. by bank loans, or fund raising via the bond and equity market.

Corporate bonds are debt securities. Purchasers of the bonds issued essentially extend credit to the company, which pays – usually fixed – interest to the securities holders periodically until the end of the tenor, while the borrowed funds are usually repaid upon maturity in a lump sum. Companies have a wide range of options for selecting the individual characteristics of the bonds to be issued, including the tenor, the currency and the type of coupon. By purchasing the bonds, investors directly finance the operation of companies, while – in contrast to equities – they acquire no ownership or voting right in the respective company, and they are not entitled to dividends from the profits. In this case, we solely talk about lending for a predefined tenor, and thus corporate bonds are typically purchased by economic agents with lower willingness to take risks than shareholders.

The corporate bond market may generate competition for the bank loans.[2] Diversified fund raising by companies may generate healthy competition between bank loans and bond market funds, as a result of which companies' funding costs may decline. In certain respects, bonds are a more flexible form of financing, since – in contrast to bank loans – in most cases the utilisation thereof is not linked to a loan purpose in the narrow sense. Corporate bonds are usually unsecured, i.e. in contrast to a typical bank loan, the company provides no collateral for the borrowed amount, but rather guarantees the bond with its assets. While the average maturity of corporate loans is relatively short and interest is often variable, companies typically issue longer-term securities with interest fixed for 5-10 years on the bond market.

A developed corporate bond market increases the efficiency of monetary policy transmission. If economic actors are also able to rely on channels other than bank loans, the central bank's interest rate decisions can influence developments in companies' funding costs more efficiently, and through that the achievement and maintenance of the price stability objective. In addition, in the event of a potential crisis, an established corporate bond market may not only help the self-recovery of the market, but also provide the central bank an opportunity to support companies' fund raising directly and efficiently, thereby reducing the dependence of the efficiency of monetary policy on bank intermediation.

On the bond market, companies are financed simultaneously by several investors rather than by a single institution, which is also favourable in terms of financial stability.[3] In the case of bonds, companies are financed directly by the investors, without bank intermediation, which also includes loan-related monitoring activity. These may be primarily institutional investors (fund managers, pension funds, insurers) and banks, but households and other enterprises may also appear among them. The broader the investor base participating in the bond market and the more liquid the market is, the lower companies' funding cost will be. In the case of bank loans, the risk related to a company typically appears in a concentrated form at a single institution (with the exception of syndicated loans), while in the case of financing from the bond market, the risk is distributed among investors.

[1] Although in the case of financial corporations, fund raising via bonds is a more common form of financing, in this paper we only deal with the bond market of non-financial corporations, which is more important in terms of the real economy. Hereinafter, company shall mean non-financial corporations, even when it is not indicated separately.

[2] For example, see: International Capital Market Association (ICMA): Economic Importance of The Corporate Bond Markets (2013).

[3] For example, see: The Emerging Markets Committee of the International Organization of Securities Commissions: The Development of Corporate Bond Markets in Emerging Market Countries (2002)

A developed corporate bond market may have a number of favourable effects on the economy not only in normal economic periods, but also in a potential crisis period. The shock absorbing capacity of a financial system that is founded on multiple pillars and includes the corporate bond market in addition to the banking system, is much higher. In several cases, it has been observed in the emerging countries that corporate bond issuance rises in periods of recession. A typical example of this included several Asian countries during the financial crisis of 1997-1998, when the credit decline entailed a fast and major increase in bond issues.[4] In parallel with the decline in banks' willingness to lend, economic agents started to finance the corporate sector directly on the bond market, thereby fostering recovery from the crisis. After the 2008 financial crisis, a similar situation took place in certain developed, EU bond markets as well: while non-financial corporations became net loan repayers in 2009, the funds raised on the bond market substantially exceeded the level observed in the pre-crisis years.

A liquid bond market may mitigate the impact of an economic crisis and shorten the duration of recovery.[5] The role of alternative financing opportunities may be key in situations where – due to loan supply constraints – the banking sector is unable to provide sufficient funds for corporate investments. The fast freezing of the credit channel in periods of crisis may abruptly set back economic activity through the decline in corporate investments; however, in such cases the bond market may come in handy, since some companies may be able to raise funds even without the cooperation of the banking sector.

Securities representing claims on several rather than on a single company may also appear on more developed capital markets. Debt securities may be created not only in relation to a single company's debt, but credit claims on multiple companies – primarily corporate loans – may also be transformed into marketable securities. Securitisation offers a good opportunity for banks to separate loan portfolios simply and transfer them to other banks or investors, which may be a useful instrument both under normal economic circumstances and in crisis periods.

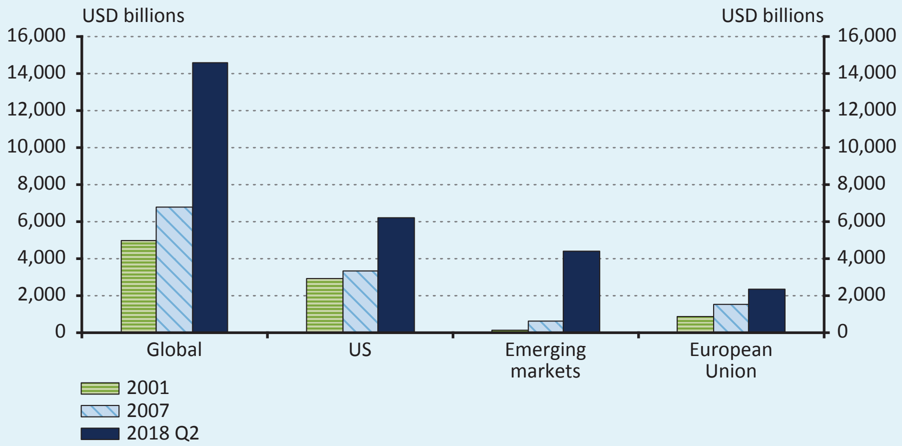
[4] For example, see: IMF Working Paper: The Development of Local Capital Markets: Rationale and Challenges – Luc Laeven (2014)
[5] For example, see: The Role of a Corporate Bond Market in an Economy – and in Avoiding Crisis, Nils H. Hakansson (1998)

2 Corporate bond market in an international comparison

2.1 OUTSTANDING BONDS OF NON-FINANCIAL CORPORATIONS ACROSS THE WORLD

Following the outbreak of the global financial crisis, the role of the corporate bond market appreciated significantly, both in the developed and the emerging countries (Chart 1). In the 2000s, until the outbreak of the crisis, the outstanding bond portfolio of non-financial corporations rose by USD 260 billion annually on average. In 2009, i.e. in the first year after the outbreak of the crisis, companies' net bond issuance was already more than three times higher and in the next 10 years as well it was around USD 800 billion per year. The increase in the role of the corporate bond market was remarkable both in the USA, a country with one of the most developed financial institutional systems, and in the emerging markets. By the end of 2018 Q2, the outstanding bond portfolio of non-financial corporations reached a historic high of USD 14,000 billion. The number of bond issuer companies also rose substantially: on the developed markets, the number of issuer companies doubled, while in the emerging markets it became almost six times higher in the past 10 years. In 2016, more non-financial corporations raised funds from the bond market in the emerging markets than in the developed countries.[6]

Chart 1
Outstanding bonds of non-financial corporations



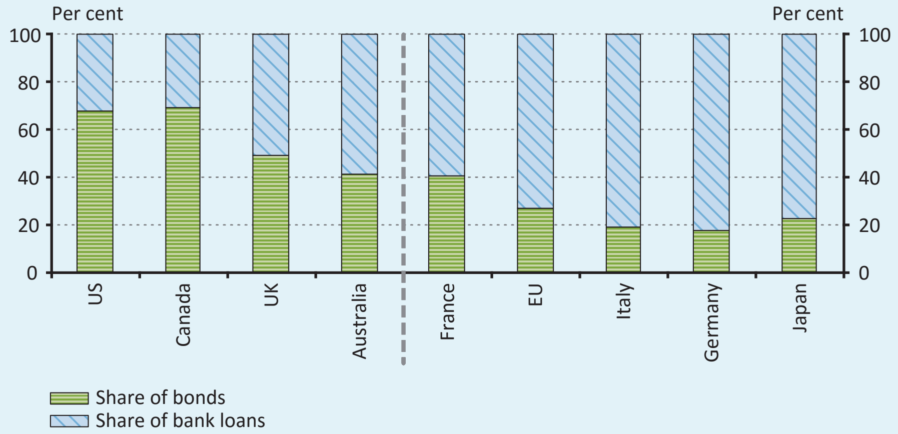
Source: BIS.

[6] Corporate Bond Markets in a Time of Unconventional Monetary Policy (2019) – OECD Capital Market Series

2.2 CORPORATE BOND MARKET IN THE USA AND IN THE ANGLO-SAXON COUNTRIES

In the Anglo-Saxon countries, due to the developed capital markets, the role of bonds in corporate financing is more significant than in the EU. The special features of the financial system substantially influence the degree of companies' presence on the bond market: while in the Anglo-Saxon countries fund raising typically takes place in the capital market, in the Continental European countries bank loans predominate. In the United States, direct financing in companies' fund raising dates back to a long time, and thus the bond market is also substantially larger. Bond issuance – primarily due to the institutional features – is a more widely known opportunity and a usual way of fund raising, accompanied by more simple processes and accordingly the costs of issuance are also lower. In the USA, bonds account for almost 70 percent of non-financial corporations' debt financing, while in the EU, and particularly in the euro area, the ratio is the opposite (Chart 2).

Chart 2
Breakdown of non-financial corporations' debt financing
(2018 Q2)



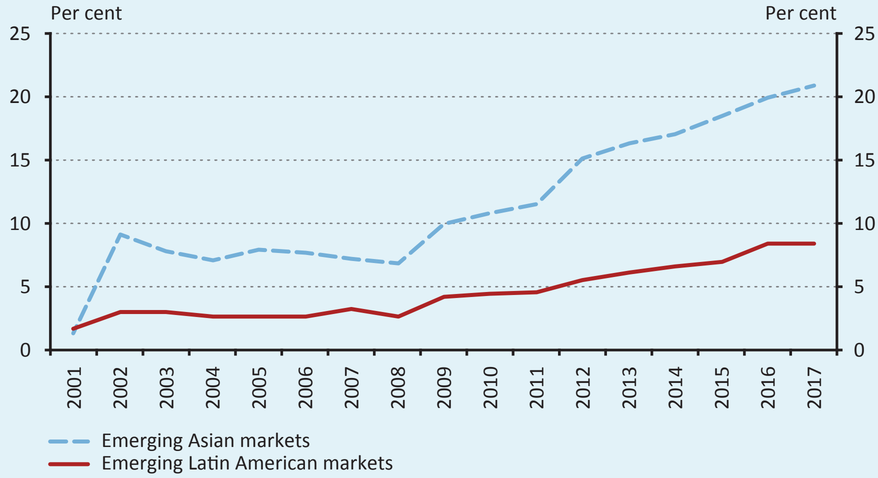
Source: BIS, Eurostat.

In the United States, the outstanding bond portfolio of non-financial corporations exceeded USD 6,000 billion at the end of 2018 Q2, which corresponds to more than 30 percent of GDP. In the pre-crisis years, the outstanding bonds of non-financial corporations as a percentage of GDP gradually declined in the USA, but after 2008 it started to grow steadily and by mid-2018 it rose from the previous 23 percent to a level exceeding 30 percent of GDP. Dynamic growth was observed in Canada as well, similarly to the USA, as the outstanding portfolio rose from 15 percent of GDP to over 20 percent already in the first post-crisis year and was around 28 percent of GDP in 2018.

2.3 CORPORATE BOND MARKET IN THE EMERGING ASIAN AND LATIN AMERICAN COUNTRIES

The corporate bond portfolio also grew in the Asian and Latin American emerging market economies in the past 10 years (Chart 3). The corporate bond portfolio of the emerging Asian countries rose substantially in the post-crisis period, which was primarily attributable to bond issuance by Chinese companies: while these companies' bond portfolio amounted to 3-4 percent of GDP in the pre-crisis period, by 2017 it already exceeded 23 percent of GDP. In addition to China, South Korea, Malaysia and Singapore also have substantial market in the region. The Latin American countries also recorded stable growth in the post-crisis years, as a result of which the corporate bond portfolio of that continent came close to 10 percent of GDP by 2016. The growth was attributable, among others, to Brazil and Mexico, which both have substantial markets, but the Chilean corporate bond market also expanded significantly. In addition, among the emerging markets, Russia also deserves attention, where after the crisis the volume of the corporate bond portfolio as percentage of GDP doubled, and according to the latest data it already exceeds 12 percent of GDP.

Chart 3
Corporate bond portfolio in emerging countries in Asia and Latin America, as a percent of GDP

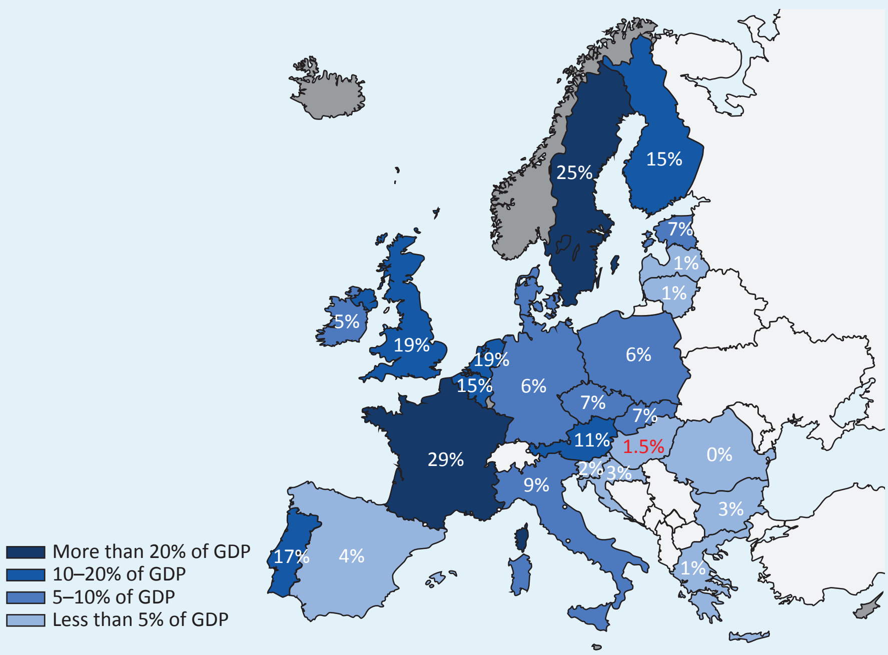


Note: In the case of certain countries data were available only for the internal market.
Source: BIS, IMF.

2.4 CORPORATE BOND MARKET IN THE EUROPEAN UNION

The size of the corporate bond market varies significantly among the EU countries (Chart 4). At end of 2018 Q2, the outstanding bonds of the EU's non-financial corporations exceeded EUR 2,000 billion, which represents roughly 13 percent of GDP. At the same time, there are major differences among the member states. The corporate bond market is typically used for fund raising by companies in the more advanced economies. The corporate bond portfolio is the largest in France, reaching almost 30 percent of GDP, followed by Sweden, the Netherlands and the United Kingdom with portfolios of around 20 percent of GDP. In the CEE countries, the funds raised by companies from the bond market do not reach 10 percent of GDP.

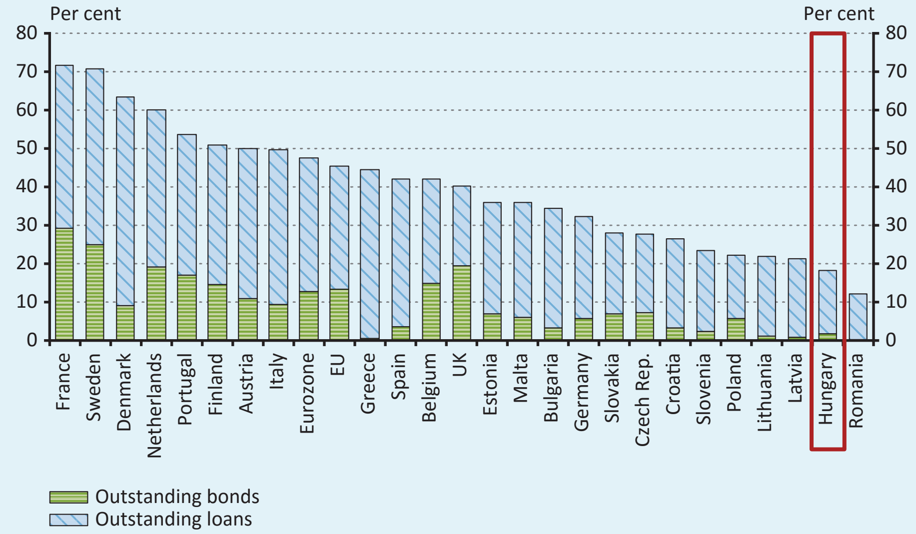
Chart 4
Outstanding bond portfolio of non-financial corporations in the European Union, as a percent of GDP
(2018 Q2)



Source: Eurostat.

Within the European Union, in the case of the less developed countries, not only is the outstanding bond portfolio lower, the total indebtedness of the companies is also lower (Chart 5). While in the case of certain more developed Western countries, the indebtedness of companies – i.e. financing in the form of bank loans and bonds – may be as high as 70 percent of GDP, in the case of the less developed countries this value is typically below 30 percent of GDP. In the case of the latter countries, including Hungary, one of the essential conditions for successful real economy convergence is financial convergence, where the banking sector and capital market deepen. There is still room in Hungary for growth in corporate indebtedness and the expansion of the range of companies resorting to financing; however, it is also important to ensure that these markets provide the necessary funding.

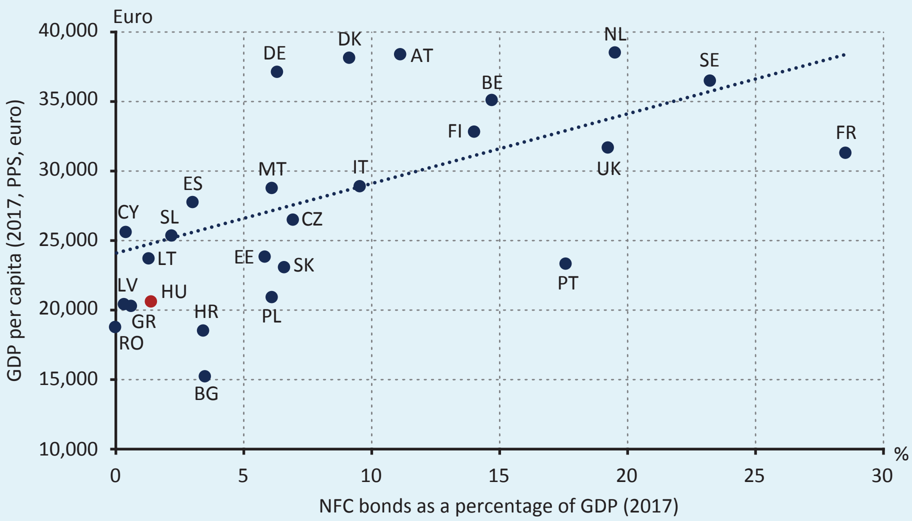
Chart 5
Outstanding bond and bank loan portfolio of non-financial corporations as a percent of GDP
(2018 Q2)



Note: Luxembourg, Ireland and Cyprus are not included in the chart due to the special features of the financial system.
Source: Eurostat, ECB.

The realisation of financial convergence is conditional not only upon the deepening of the banking sector, but also of the corporate bond market. In Hungary, the supportive contribution of the banking sector through lending is particularly important, since financing is essentially focused on banks, while convergence requires contribution from other forms of financing as well. There is a positive correlation between economic development and the outstanding bonds of non-financial corporations as percent of GDP (Chart 6); in the more developed countries of the European Union, not only the total indebtedness of the companies, but also the volume of their funds raised on the bond market substantially exceeds that observed in the less developed countries. In the countries with high GDP per capita, the capital market often plays an important role, as it facilitates the satisfaction of companies' higher borrowing requirement with a wider investor base.

Chart 6
Outstanding bond portfolio of non-financial corporations and GDP per capita
(2017)



Source: Eurostat.

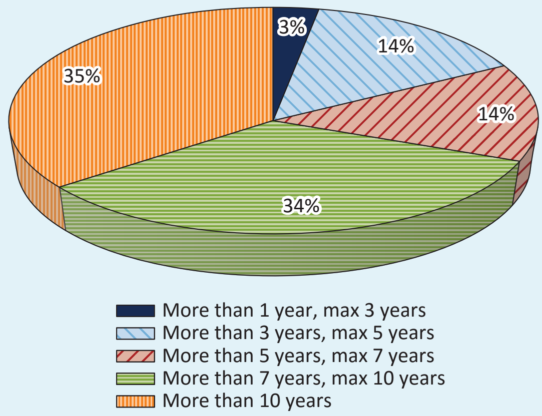
2.4.1 Corporate bond market of the euro area

70 percent of the European Union's outstanding corporate bond portfolio is related to the euro area. The portfolio of EUR 1,400 billion, similarly to the EU as whole, amounts to 13 percent of GDP, accounting for roughly one quarter of companies' debt liabilities. In the euro area, the bond portfolio of French companies stands out: at the end of 2018 Q2 it was almost 30 percent of GDP. The high outstanding bond portfolio of French companies is mostly related to public corporations that are also active on the bond market. This is followed by the Dutch corporate bond market, which grew remarkable since the crisis and also attracted many German companies, and by the Portuguese bond market, while Greece, Latvia and Lithuania – which rely almost fully on the banking sector and have outstanding bond portfolios of less than 2 percent of GDP – are at the end of the list.

Roughly 70 percent of non-financial corporations' bonds have maturity longer than 7 years (Chart 7). Corporate bonds are typically a long-term form of financing, which is also reflected by the euro area bond portfolio: while the portfolio of bonds with maturity up to 3 years accounts for merely 3 percent of the total portfolio, bonds with maturity over 5 years account for 83 percent. The ratio of bonds with maturity longer than 10 years is 35 percent, representing the highest share within the portfolio.

70 percent of the issues are made in euro. Companies in the euro area mostly, i.e. in about 70 percent of the cases, raise funds for the activity through bonds denominated in euro. One quarter of the issued bonds are denominated in USD, while 5 percent of them are outstanding in GBP.

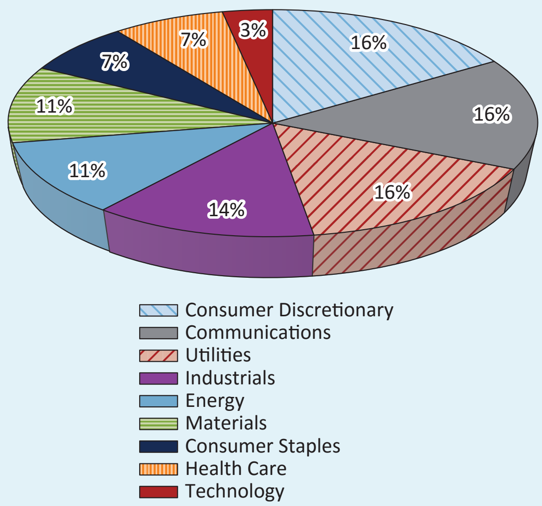
Chart 7
Breakdown of bonds of non-financial corporations by original maturity
(2018 Q2)



Source: Bloomberg.

Companies from a wide range of industries appear on the bond market (Chart 8). The largest ratio of the companies present on the corporate bond market of the euro area come from the consumer discretionary, communications and utility sectors, each covering 16 percent of the entire market. They are followed by the industrial, energy and materials sectors, also with a share over 10 percent; the technology sector has the smallest share.

Chart 8
Breakdown of non-financial corporations' bonds by sectors in the euro area
(2018 Q2)

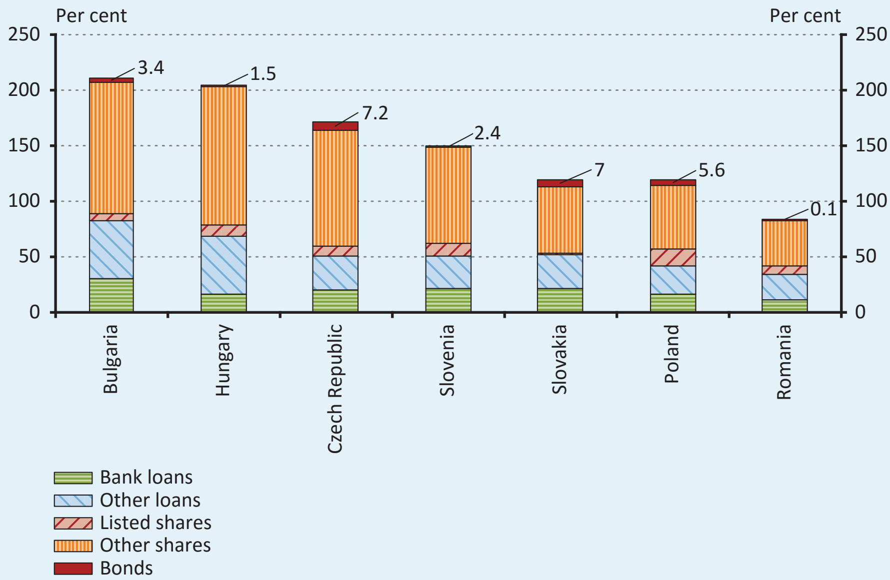


Note: Based on the sector classification of Bloomberg.
Source: Bloomberg.

2.4.2 Bond market of the Central and Eastern European (CEE) region

In the CEE region, the bond portfolio grew in the post-crisis years, but it still falls short of the level observed in certain more developed European countries. Within the CEE countries not using the euro, the Czech Republic and Poland have the largest corporate bond portfolios as a percent of GDP, which exceed 5 percent of GDP in both countries. At the same time, the GDP-proportionate volume of both the Czech and the Polish bond markets falls substantially short of the euro area average. Among the countries in the region, the corporate bond market is one of the smallest in Hungary, amounting to 1.5 percent of GDP at the end of 2018 Q3 (Chart 9).

Chart 9
Non-financial corporations' liabilities as a percent of GDP in the countries of the region
(2018 Q2)



Source: Eurostat.

The size of the Czech and Polish corporate bond market is similar, but there are major differences between the two markets (Table 1). While in the Czech Republic the market is mostly characterised by fixed-rate corporate bonds, in Poland – similarly to lending – mostly variable-rate securities are issued. In addition, there is also a large difference in the currency ratio of the two countries' bonds: while in the Czech Republic three quarters of the bond market is denominated in euro, in Poland the vast majority of the entire portfolio is issued in zloty and only a bit more than 10 percent was issued in euro. The difference in the bond spreads is smaller in the two countries: the spread of fixed-rated bonds is around 250-300 basis points, while that of variable-rate bonds is around 200-250 basis points. There is also a significant difference between the average issue size: the average issue by Polish companies is around EUR 17 million, while in the Czech Republic it exceeds EUR 150 million.

Table 1
Corporate bond market of the Czech Republic and Poland
(2018 Q2)

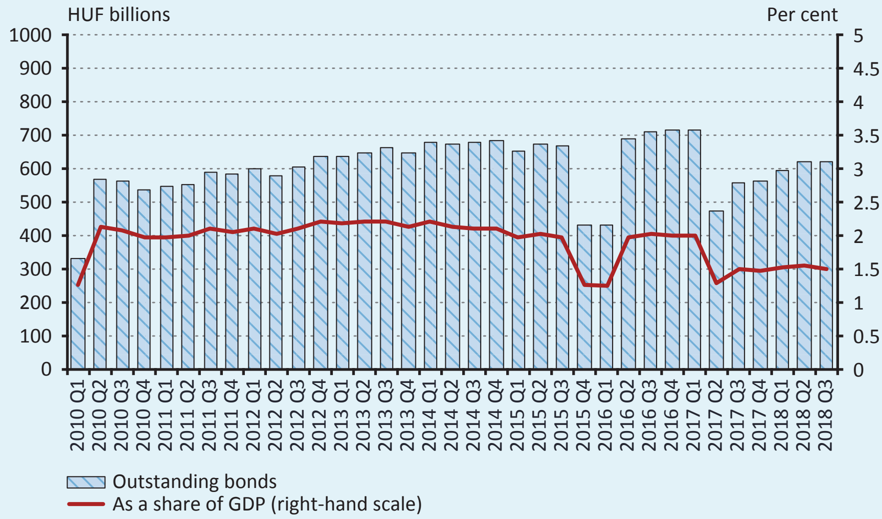
	Czech Republic	Poland
NFC's debt securities (as a percentage of the GDP)	EUR 14.3 bn 7.2%	EUR 26.6 bn 5.6%
Bonds number	58	217
Issuers number	24	73
Average issuance size	EUR 155 millions	EUR 17 millions
Share of fixed rates	63%	10%
Share of EUR denomination	75%	13%
Spreads of fixed rates	280 bp	300 bp
Average spread of the floating rates	240 bp	260 bp

Note: the data related to market size are based on the data available at Eurostat, while the rest of the information is based on data published by Bloomberg. Bloomberg does not publish data for the full range of bonds, but this has no effect on the key findings of the analysis. In the case of securities issued in domestic currency, the spread is relative to government securities yields, while in the case of EUR securities to the EUR swap curve.

Source: Eurostat, Bloomberg.

The outstanding bond portfolio of Hungarian non-financial corporations in 2018 Q3 was HUF 620 billion (EUR 1.9 billion). In past years, the corporate bond portfolio was continuously around HUF 600 billion, albeit a decline of around HUF 200 billion was recorded both in 2015 and 2017. In the past quarters a moderate rise was observed, and thus by the end of 2018 Q3, the outstanding portfolio once again slightly exceeded HUF 600 billion (Chart 10). However, the size of the Hungarian corporate bond market, which amounts to 1.5 percent of GDP, is still well below the value observed in the countries of the region.

Chart 10
Developments in the outstanding bond portfolio of Hungarian non-financial corporations



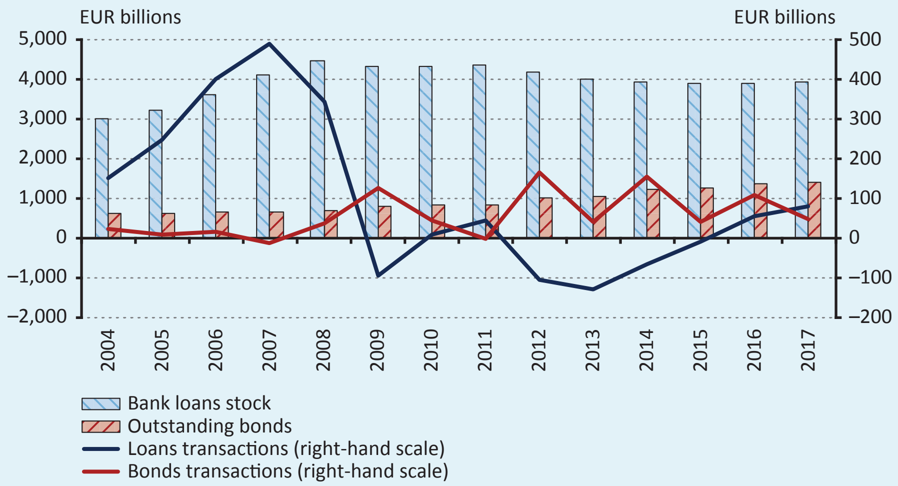
Source: MNB.

About half of the outstanding bonds of Hungarian companies were issued in Hungary. Roughly half of the portfolio is outstanding abroad in euro, while the other half thereof in Hungary in forint. At the end of 2018, of the bonds issued in Hungary, the portfolio listed on the stock exchange amounted to merely HUF 21 billion, accounting for 3 percent of the total bond portfolio. A more active presence on the stock exchange could make the allocation of capital more efficient in Hungary as well: it would facilitate access to a broader range of investors interested in bonds and that would also reduce the companies' capital market funding costs.

3 Role of the corporate bond market during the crisis

In the euro area, after the outbreak of the economic crisis, the volume of outstanding bank loans declined, while the corporate bond portfolio gradually rose (Chart 11). In the pre-crisis years, the outstanding amount of loans of corporations rose substantially in the euro area: the transaction-based growth rate of lending steadily exceeded 10 percent per annum, and in certain segments lending was characterised by overheating. In 2007, in the last pre-crisis year, corporate loans outstanding already reached almost 8 percent of GDP, while in the Mediterranean countries the growth was even stronger. However, as result of the crisis, major deleveraging was observed: corporate loans outstanding from banks declined substantially, and in parallel with this the bond market volume rose. Mostly as a result of the major balance sheet deleveraging of the Spanish and Italian banking sectors, loans outstanding started to decline, while companies raised funds from the bond market in excess of EUR 100 billion annually, compared to the value of less than EUR 20 billion observed in the pre-crisis years. In the last 10 years, the value of French and Italian companies' outstanding bond portfolio has doubled as a percentage of GDP.

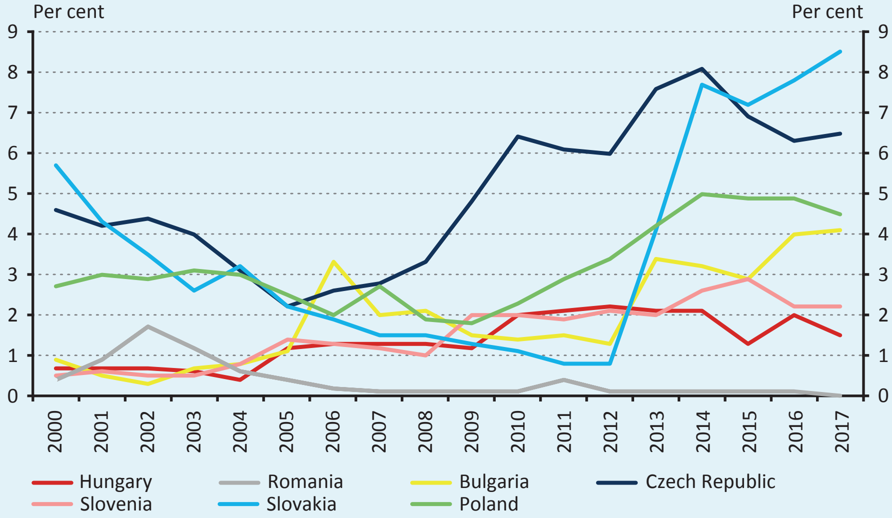
Chart 11
Fund raising by non-financial corporations in the euro area



Source: Eurostat.

Among the regional countries corporate bond market of the Czech Republic and Poland expanded since the beginning of the economic crisis until 2014 (Chart 12). In the countries of the region, in the Czech Republic and Poland – which have the second and third largest corporate bond markets after Slovakia – steady growth was observed after the 2008 crisis. Since 2014, the size of the markets in Poland and in the Czech Republic has no longer increased, with the portfolios at around 5 and 7 percent of GDP in recent years, respectively. The liquidity of the Hungarian corporate bond market did not improve substantially in the post-crisis years: starting from 2013 the central bank focused primarily on the recovery of the credit channel, that plays a more significant role in financing.

Chart 12
Outstanding bond portfolio of non-financial corporations of the countries of the region, as a percent of GDP



Note: The sharp increase in Slovakia in 2013-2014 can be attributed to one-off items.

Source: Eurostat.

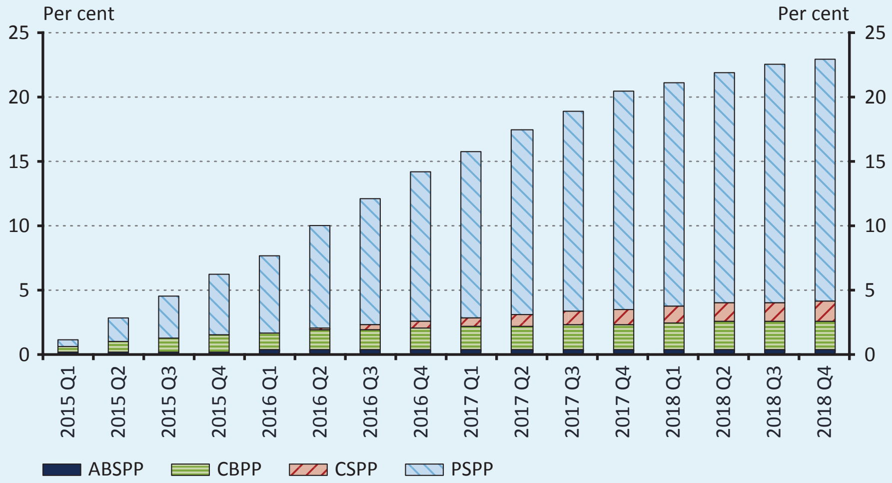
4 Central bank bond purchase programmes

In 2016, both the European Central Bank (ECB) and the British central bank (Bank of England, BoE) – in addition to their unconventional monetary policy instruments – decided to launch a corporate bond purchase programme. The two central banks started the purchases with similar objectives and with similar scope, but there were differences as well.

4.1 THE ECB'S CORPORATE SECTOR PURCHASE PROGRAMME (CSPP)

In March 2016, the ECB announced that it would extend its existing asset purchase programme to the purchase of bonds issued by non-bank corporations. Within the scope of the Corporate Sector Purchase Programme (CSPP), six national central banks made purchases on behalf of ECB from June 2016, purchasing securities of companies with at least investment grade credit rating registered in the euro area. The conditions of the programme stipulated that the ECB would purchase at most 70 percent of a bond series, while the residual maturity of the bonds could be between 6 month and 30 years.

Chart 13
Volume of the ECB's asset purchase programmes as a percent of GDP



Note: ABSPP: asset-backed securities purchase programme; CBPP: covered bond purchase programme; CSPP: corporate sector purchase programme; PSPP: public sector purchase programme.

Source: ECB.

The purpose of corporate bonds purchasing programme was to further ease monetary policy and reduce companies' financing costs (Table 2). With the purchase of corporate bonds, the primary objective of ECB was to ease the financing conditions of the real economy. By purchasing corporate bonds, the ECB wanted to achieve further easing of the monetary stance, which facilitates achieving the inflation target in a sustainable manner. Furthermore, the communication of the ECB emphasised that not only large companies can benefit from the advantages of the corporate bond purchase programme, but it may be also favourable for small and medium-sized enterprises, since there will be more room for their financing in banks' balance sheet, thereby reducing SMEs' funding costs. The ECB highlighted that the programme has a favourable impact on economic growth, thanks to the growth of investments and job creation.

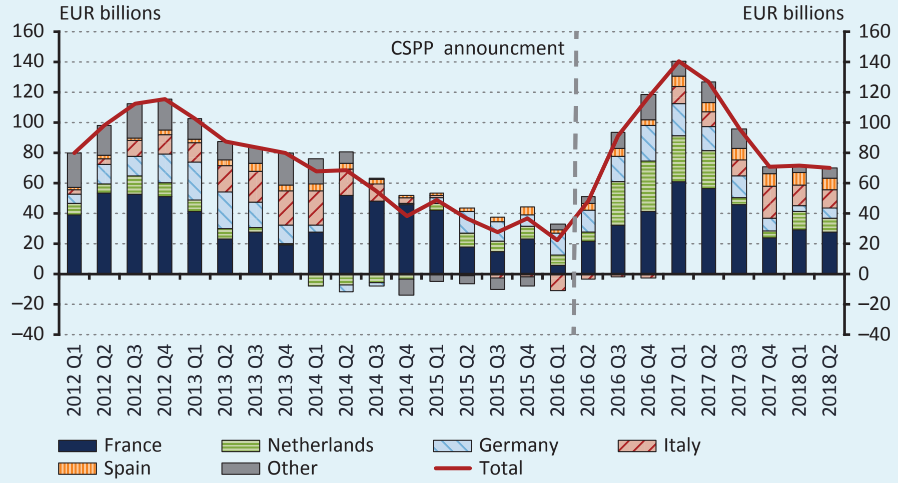
Table 2
The ECB's Corporate Sector Purchase Programme (CSPP)

	CSPP
CSPP's aims	Strengthen the pass-through of the Eurosystem's asset purchases to the financing conditions of the real economy.
CSPP's time frame	June 2016 - December 2018
Debt securities eligible for purchase	EUR 920 bn
Debt securities purchased (as a percentage of the GDP)	EUR 178 bn (1,6%)
Share of purchases	19%
Number of issuers in the CSPP	274
Denomination	Euro
Credit rating of debt securities	At least rating of BBB-
Maturity of debt securities purchased	Minimum remaining maturity of six months and a maximum remaining maturity of 30 years
Purchases conducted in	In the primary and secondary markets

Forrás: ECB.

The bond issuance of non-financial corporations established in the euro area rose significantly in the second half of 2016, with the announcement of the ECB's corporate bond purchase programme playing a key role in this regard. After 2012, the value of corporate bond issues had gradually declined in the euro area countries, and in the quarter preceding the announcement of CSPP by ECB, the value of annual issues fell – from the previous value of over EUR 100 billion – to EUR 22 billion. In parallel with the start of the corporate bond purchases after the central bank's announcement, the issuance volume rose substantially, which was primarily attributable to bond issues by French and Dutch companies, but bond issues by Italian and German companies also rose moderately. Altogether, we can say that the new bond issuances were concentrated in few countries, and after 2017 Q2 the level of bond issues started to decline. In 2018 the annual volume of bond issues was around EUR 70 billion (Chart 14).

Chart 14
Bond issue by non-financial corporations in the euro area
(annual)



Source: Eurostat.

As a result of the CSPP, the volume of corporate bond issues rose and spreads fell significantly. Although after the start of the programme, the number of issued corporate bonds did not grow, the spread of newly issued bonds declined at all tenors, i.e. companies had access to cheaper financing. The declines in the corporate bond spreads were observed not only in the case of the securities eligible for purchase in the programme, as a significant decline was registered also for non-eligible securities in 2016 (Chart 15). There is a substantial difference between the ratio of fixed-rate bonds based on tenor. While only one third of the three-year bonds were issued with fixed coupon, this ratio is two thirds in the case of the five-year bonds and more than 80 percent in the case of the ten-year bonds. After the launch of the CSPP, there was a minor decrease in the ratio of fixed-rate bonds, while the ratio of long-term bonds increased slightly between the two periods under review.

Table 3
Key features of the euro area's corporate bond market

	2013-2015			2016-2018		
	3 years	5 years	10 years	3 years	5 years	10 years
Outstanding amount of NFC's bond market (as a share of the GDP)	11.6%			12.8%		
Number of new bonds	416	1467	535	243	1039	454
Number of new issuers	143	762	270	100	602	292
Share of fixed rates	36%	68%	89%	36%	64%	81%
Average spread (bp)	60	107	87	35	104	71

Note: the spreads are values calculated relative to the EUR swap curve.
Source: Bloomberg, Eurostat.

Chart 15
Developments in corporate bond spreads in the euro area

Source: Citi Research, ECB.

In December 2018, the ECB ended the net purchase under the CSPP, but has maintained the size of the existing portfolio. In June 2018, the ECB decided to phase out its asset purchase programmes in two steps, it reduced the volume of the monthly purchases and decided to stop the programme at the end of 2018. Since December 2018 – similarly to the rest of its asset purchase programmes – no further securities are purchased under the CSPP to increase the portfolio. However, it reinvests the principal repayments of maturing bonds, i.e. it intends to maintain the portfolio of around EUR 178 billion that has been built up.

4.2 CORPORATE BOND PURCHASE SCHEME OF THE BANK OF ENGLAND

The British central bank (Bank of England, BoE) launched its Corporate Bond Purchase Scheme (CBPS) in September 2016, as part of a package aimed to support growth and achieve inflation in a sustainable way. The fiscal stimulus package to mitigate the negative effects of Brexit, among other things, included, *inter alia*, cutting the base rate, increasing the facility amount of the previous asset purchases and launching the CBPS. Securities eligible for purchase under the programme included GBP-denominated bonds of non-financial corporations contributing to the economy of the United Kingdom with GBP 10 billion budgeted for this purpose. The length of purchases was planned for a maximum of 18 months, but the portfolio reached the maximum volume in April 2017. Since that time, the BoE only maintains the size of the portfolio without further purchases.

In addition to further monetary policy stimulus, the purpose of the BoE's corporate bond purchases programme was to reduce interest rate spreads and increase the number of new issues. Upon announcing the scheme, the BoE noted that in its view the impact of the corporate bond purchases may be more robust in monetary policy terms than the previously applied government bond purchases. As a reason for this, it mentioned that the economic participants from which the central bank is going to purchases the corporate bonds are more likely to reinvest the released capital than those from which the less risky government bonds are purchased.

As a result of the CBPS, corporate bond spreads declined and the portfolio of GBP-denominated bonds rose significantly. The presence of the central bank on the corporate bond market among others caused a decline in the liquidity premium. Already on the day of the announcement of the programme, the spread on investment grade non-financial corporations' GBP-denominated bonds dropped by 10 basis points, and in the period thereafter it declined by another 10 basis points. After the purchases, spreads on GBP-denominated bonds – similarly to USD bonds – were steadily at 120-140 basis points.

Table 4
Corporate Bond Purchase Scheme of the Bank of England

CBPS's aims	Impart monetary stimulus, reducing the cost of borrowing for companies, stimulating new issuances
CSPP's time frame	September 2016 – April 2017
Debt securities eligible for purchase	£ 133 billion
Debt securities purchased (as a percentage of the GDP)	£ 10 billion
Purchases share	8%
Number of issuers in the CBPS	144
Denomination	Sterling
Credit rating of debt securities	Minimum BBB-
Maturity of debt securities purchased	At least 12 months
Purchases conducted in	Secondary market

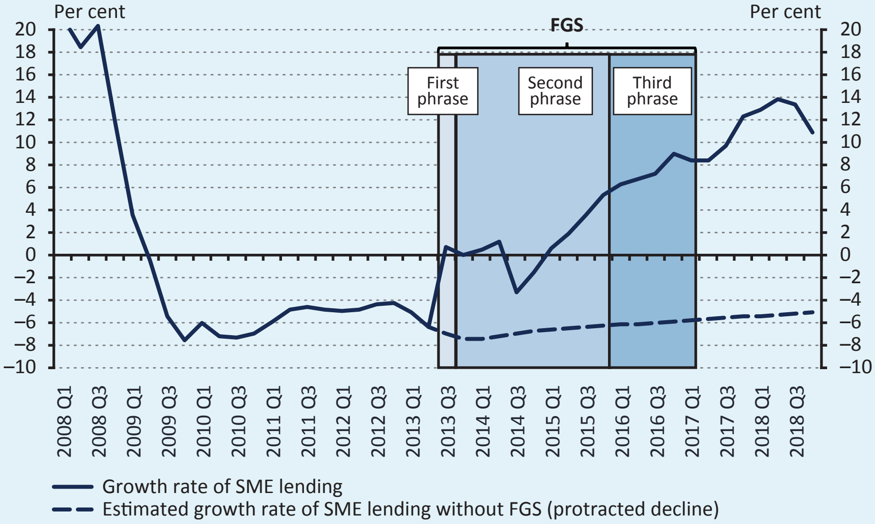
Forrás: Bank of England.

5 Bond Funding for Growth Scheme (BGS) of the Magyar Nemzeti Bank

From 2013, one of the key objectives of the MNB was to mitigate SME credit market disturbances, which was successfully achieved with the Funding for Growth Scheme. Following the outbreak of the financial and economic crisis in 2008, in Hungary the loans outstanding of corporations – and particularly of SMEs – recorded an extreme fall even by international standards. As a result of the roughly 5 percent annual decline for almost 5 years, by the beginning of 2013 the loans outstanding shrank to 75 percent of the pre-crisis level. The economy faced the phenomenon of a 'credit crunch', which required intervention by the central bank. With an aim to restoring the functioning of the SME credit market, as a key channel of the monetary policy transmission, in June 2013 the MNB launched the Funding for Growth Scheme (FGS).

The scheme contributed to the turnaround in lending and thus also had a material impact on economic growth. With financing conditions more favourable and by facilitating the implementation of numerous investments, the FGS – according to the MNB's latest estimates – contributed to the economic growth between 2013 and 2018 by roughly 3.5 percent (while in this period the contribution of the monetary policy as a whole may have been around 6 percent). Beyond improving the conditions of SMEs' access to credit, the scheme also exerted a major indirect effect by reconstructing a credit market that had not worked properly before, which represents an additional long-term – stretching beyond the duration of the scheme – contribution to economic growth. In the past years, the transaction-based annual growth rate of both the entire corporate sector's and the SME sector's loans outstanding rose dynamically: in 2018, the growth rate reached almost 12 percent (Chart 16). Considering that an increase of 1 percentage point in the corporate loans outstanding is typically accompanied by GDP growth of 0.25 percentage point, today economic growth already relies on bank loans, i.e. it is realised from internal funds.

Chart 16
Growth rate of loans outstanding of the SME sector



Note: transaction-based growth rate.
Source: MNB.

The volume of corporate lending in Hungary is already adequate, but companies tend to rely on the banking system to an extreme degree. In the past few years, the loans outstanding of the entire corporate sector and of the SME segment both rose substantially; the funding level of the sector may be deemed adequate. At the same time, the structure of funding could be improved further both in the case of SMEs and large companies. Among the loans of the SME sector, the ratio of long-term, fixed-rate loans is still low, which the central bank seeks to divert to a sounder structure through the FGS *fix* scheme, launched at the beginning of 2019. In the case of large companies, a liquid bond market, competing with bank loans, may be key to creating a proper funding structure. At present, due to the small size and low liquidity of the Hungarian bond market, fund raising through bonds is not a realistic opportunity either for large companies or for SMEs. Although bond issuance may represent an alternative to bank financing primarily for the larger companies, with the development of the market, later on credit claims on SMEs may also appear in securitised form, which may result in further improvement in financing conditions for the SME sector.

With an aim to improve the efficiency of monetary policy transmission and increasing the liquidity of the corporate bond market, the MNB is launching the Bond Funding for Growth Scheme (BGS). From mid-2019, the MNB – supplementing its present set of unconventional monetary policy instruments – will launch a corporate bond purchase programme with a facility amount of HUF 300 billion, within the scope of which it will buy the bonds of non-financial corporations of good credit rating. Furthermore, within the scope of the scheme, it will be also possible to purchase securities backed by corporate loans, through which the MNB wishes to contribute to the spread of securitisation in Hungary. With this scheme, which fits into the series of the MNB's previous measures facilitating the funding of companies, the central bank is following the practice of the leading European central banks, i.e. the ECB and BoE, which also purchased corporate bonds as part of their set of unconventional monetary policy instruments.

Table 5
Main parameters of the Bond Funding for Growth Scheme

Total amount	HUF 300 bn (0.7 percent of GDP)
Start of the purchases	1 July 2019
Issuers of the bonds to be purchased	domestic non-financial corporations
Denomination of the bonds to be purchased	HUF
Original maturity of the bonds to be purchased	minimum 3 years, maximum 10 years
Credit rating of the bonds to be purchased[7]	at least B+
Proportion of MNB's purchase per bond series	max. 70 per cent
Maximum exposure of the MNB per corporate group	HUF 20 bn
Minimum volume per issuance	HUF 1 bn
Sterilisation of the excess liquidity arising from the purchases	by the preferential deposit facility

Note: The detailed terms and conditions of the scheme will be published on the MNB's website.
Source: MNB.

The BGS contributes to increasing the efficiency of monetary policy transmission. As presented in the section on international comparison, the funding of the Hungarian non-financial corporations from the bond market lags behind not only the average of the euro area, but also that of the countries of the region. The debt liabilities of Hungarian companies are dominated by bank loans and only a very small segment of the companies have access to the bond market. By increasing the liquidity of the bond market, the MNB seeks to achieve that Hungarian companies also rely on financing forms other than bank loans to a sufficient degree. This may contribute to improving the efficiency of monetary policy transmission, since healthy competition between the markets supplying companies with funds may raise the effectiveness of the central bank's interest rate decisions, and thus several channels of transmission will be able to provide efficient support for achieving the inflation target in a sustainable manner.

[7] Sovereign credit rating of Hungary on 26 March 2019: BBB (S&P), BBB (Fitch), Baa3 (Moody's).

The scheme contributes to the further strengthening of financial stability. In the previous sections, we presented that a potential crisis may lead to the freezing of the credit channel, which may also curb economic growth through the decline in investments. If through a developed, liquid bond market, economic agents have the opportunity to finance companies directly – without the cooperation of the banking sector – it could soften the impact of the crisis and may also shorten the time needed for recovery.

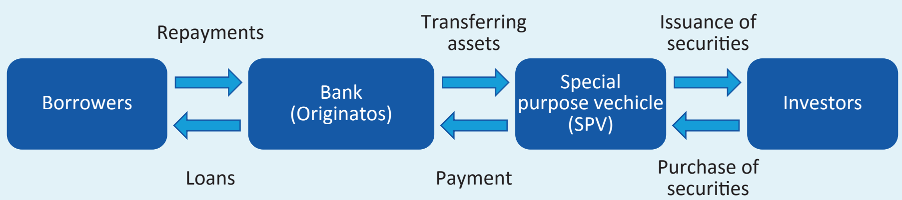
The scheme has no effect on the monetary policy conditions, it is neutral in terms of the present stance of the interest policy. The MNB will sterilise the surplus liquidity generated in the banking system as a result of the purchases made by the central bank within the scope of BGS, by the preferential deposit facility paying interest at the base rate, in line with the prevailing monetary policy framework. From now on, the preferential deposit facility will simultaneously sterilise the excess liquidity from the Funding for Growth Scheme Fix (FGS *fix*) and from the BGS, and thus the size of the portfolio crowded out from the instruments paying interest at base rate will not increase due to the BGS. The preferential deposit facility is available to the banks participating in certain central bank's schemes since February 2016. Utilisation of the instrument in the past 12 months exceeded 90 percent, which shows that it is able to provide efficient support for certain central bank schemes.

The MNB will extend the range of securities eligible as central bank collateral with the bonds also purchased by it, thereby providing regulatory support and increasing investor demand for bonds. In addition to expanding the range of eligible instruments, with a view to encouraging the issuing of quotes, the MNB will also provide the market maker credit institutions with a securities lending facility. The available quotes facilitate market liquidity, and thus the range of investors may broaden as a result of the availability of price monitoring, thereby supporting diversified corporate financing. The market makers will be able to perform their quoting obligations under all circumstances with the securities acquired within the securities lending facility.

6 Annex – securitisation in the European Union

Securitisation is a structured financial transaction, where cash flow generating assets – e.g. bank loans – are transformed into marketable securities. The most important actors of the transaction are: 1) the 'originator', i.e. usually the bank which owns the assets by which the security issuance is backed, 2) the issuer of the securities, a special purpose vehicle (SPV) and 3) the investors purchasing the securities (Chart 17). In addition, many other actors can be connected with the securitisation, such as the financial institution arranging the entire process, the credit rating agency which rates the securities and the swap-partner participating in managing the interest rate and/or exchange rate risk stemming from the different features of the cash flows of the underlying assets and the securities. Securitisation has two basic types: 'true sale' securitisation, where both the assets and the related risks are removed from the balance sheet of the originator and synthetic securitisation, where only the risks are transferred through credit derivatives. In the European Union, true sale securitisation is more common, while synthetic securitisation is less popular. The process of true sale securitisation starts with pooling and transferring a group of exposures (e.g. corporate credit claims) by the originator to a special purpose vehicle, which is a distinct entity – among others – in terms of risks. This corporation issues the securities backed by the assets. The securities are purchased by the investors who later realise the interest payments and the principal repayments on the securities, based on the cash flows of the underlying loans.

Chart 17
Schematic illustration of the loan securitisation



Source: MNB edition.

In true sale securitisation, the credit risk associated with the pool of exposures are divided into tranches with different yields and risks. After selecting assets with similar features, belonging to a homogenous group (e.g. corporate loans), the collaterals are assessed, the risks attached to the cash flows are identified and potential losses are quantified. Backed by the pooled assets, tranches with different credit rating are formed, therefore investors with different risk appetite are able to choose their preferred investments. The basis of the difference between the tranches is essentially the sequence of the payments on the securities, depending on the payments of the underlying claims. Tranches are usually classified into three categories: (1) 'senior tranche' with the highest credit rating, entitled to payment first, thereby having the lowest risk, (2) 'mezzanine tranche' and (3) 'junior tranche', the holders of these suffer the highest loss in the event of the default of the underlying assets.

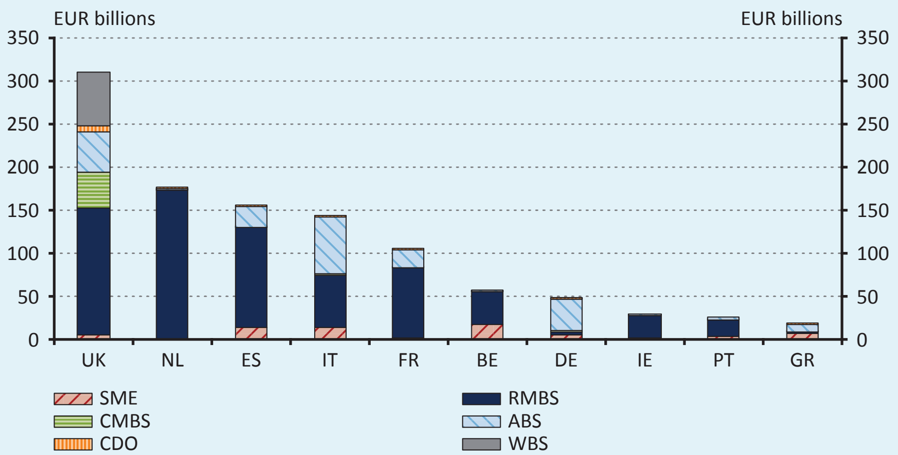
Securitisation may offer a number of advantages to economic actors. The motivation for the originator is usually that the securitisation may improve compliance with the regulatory capital requirements, the loans removed from their balance sheet may increase lending capacity, and certain portfolio segments can be separated in a targeted way, as a result of which the structure of the balance sheet may improve. On the other side, investors with different risk appetite may diversify their portfolio with the purchase of the highest rated securities, whereas investors with a willingness to take higher risks may realise higher yields by buying lower rated securities.

Table 6
Main securitised products and underlying collaterals

	Type of structured securities	Acronym	Underlying collateral
MBS	Residential mortgage-backed securities	RMBS	Residential mortgage loans
	Commercial Mortgage-Backed securities	CMBS	Commercial mortgage loans
ABS	Consumer ABS		Credit card receivables, car purchase loans, consumer loans
	Commercial ABS		Commercial loan, receivables from intangible assets
	Whole business securities	WBS	Securitisation of a company's cash flow
	Other		Receivables related to concession or use of infrastructure (e.g. road toll)
CDO	Collateralised Loan Obligation	CLO	Corporate loans
	Collateralised Bond Obligation	CBO	Bonds
	Collateralised Fund Obligation	CFO	Funds' assets

In the European Union, the securitisation of mortgage loans is the most common type of securitisation (Chart 18). At the end of 2018 Q3, the securitisation market of the European Union amounted to roughly EUR 1,000 billion, which falls well short of the US market, at roughly EUR 9,000 billion. A major difference between the two markets is that while in the EU the pooling of assets related to the banking sector is the typical practice, in the USA the securitisation of assets outside the banking sector is also common**.** Within the European Union, about half of the securitisation is related to residential mortgage loans. Besides, in certain countries (particularly in Germany and Italy) the securitisation of car loans, consumer loans and commercial loans is also significant, while securitisation of corporate loans account for 5-6 percent of the total portfolio.

Chart 18
Distribution of certain countries' securitised products and the entire portfolio
(2018 Q3)



Note: The explanation of the categories is shown in Table 6.
Source: AFME.

CONSIDERATIONS BEHIND THE LAUNCH OF THE BOND FUNDING FOR GROWTH SCHEME (BGS)

AND MAIN FEATURES OF THE PROGRAMME

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H-8200 Veszprém, Tartu u. 6.

mnb.hu

1054 BUDAPEST, SZABADSÁG TÉR 9.