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Report on the Session of the Money and Capital Market Section and on the Panel Discussion of the Innovation Section of the Annual Congress of the Hungarian Economic Association in 2019*

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The annual congress of the Hungarian Economic Association (HEA), celebrating the 125th anniversary of its foundation, was held between 5 and 7 September 2019 for the 57th time, in Nyíregyháza. This meeting is the one of the most traditional and at the same time the largest annual conference of the community of Hungarian economists. At the conference, seven thematic section meetings were held, in addition to the opening and the plenary meetings. The keynote speeches were delivered by *György Matolcsy*, Governor of the Magyar Nemzeti Bank (MNB), *István Nagy*, Minister of Agriculture, *László Domokos*, President of the State Audit Office, and *Bertrand Bonhomme*, Michelin Group's Director for Sustainable Development. This report provides information on the meeting of the Money and Capital Market Section and on the panel discussion of the Innovation Section.

As in the previous years, the Money and Capital Market Section attracted the largest audience. Moderated by *Márton Nagy,* presiding chair, Deputy Governor of the MNB and President of HEA's Financial Section, panel discussions with the top bank managers and key players in the financial sector were conducted on the following four topics: a) Criteria for the sustainable banking sector; b) Prospects for the capital markets in light of the 2019 regulatory changes; c) Fostering the instant payment system and electronic payments; and d) Experience gained from the launch of the Bond Funding for Growth Scheme.

The panel discussion of bank managers at the morning meeting took stock of the criteria for a sustainable banking sector and the factors that may make the banking sector even better. It is a rare occasion when eight outstanding personalities from the banking sector meet and discuss the key issues of the sustainable banking sector

* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

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together. The participants of the panel discussion, in addition to *Márton Nagy,* were *Éva Hegedüs,* Chairperson and CEO of GRÁNIT Bank Zrt, Secretary General of HEA, *Ádám Balog,* CEO of MKB Bank Nyrt. and Vice President of HEA, *László Bencsik,* Deputy CEO of OTP Bank Nyrt., *László Harmati*, Deputy CEO of Erste Bank Hungary Zrt., *Pál Simák,* Chairman and CEO of CIB Bank Zrt., *Balázs Tóth,* Chairman and CEO of UniCredit Bank Hungary Zrt, and *József Vida,* Chairman and CEO of Magyar Takarékszövetkezeti Bank Zrt. In his opening speech*, Márton Nagy* noted that compared to the size of the banking customer base there are still too many banks in Hungary. In the first set of questions, he raised the issue as to *whether the profit of banks is sustainable.* In connection with this, additional questions included the optimal degree of financial deepening (on the household and corporate market), how fast it should be achieved, whether in parallel with financial deepening we can also expect consolidation and increased efficiency, and whether the structure of profit (interest and non-interest income) will change and if so, in what way. *Márton Nagy* noted that the profitability of banks in Hungary was outstanding in 2018 (the ROE of 14.6 per cent was the highest in the region). The banking sector of the CEE region achieved one of the most dynamic growth rates globally as well. The data clearly reflect that – in parallel with convergence – there is still significant room for further financial deepening. The bank executives agreed that there is great growth potential in lending to households, since outstanding lending is still low compared to the region. The lag is smaller in the area of corporate loans, which is mostly attributable to the MNB's funding for growth schemes. Due to the low level of interest rates, the interest margin (and thus interest incomes as well) is stagnating or decreasing, and accordingly profitability may also decline, although opinions differed in respect of the latter. Some of the participants took an optimistic view of the situation and anticipated an increase in interest revenues. Expenditures are dominated by IT expenses and wage costs. The cost-to-income ratio of the banking sector is high in a regional comparison. Over the longer run, digitalisation may reduce the cost of banking operations to a great extent. Opinions varied on the anticipated developments in consolidation. One of the commercial bank representatives did not find this necessary, while the executive of another bank emphasised quite the opposite, saying that sustainable operations cannot necessarily be financed with less than half a million household customers per bank.

The second topic was *lending to households and the housing market:* who is eligible for a loan today and who is able to buy a home? *Márton Nagy* said that the housing market had seen a rapid upswing, but new supply was limited and the renewal of the stock of dwellings was slow. In Budapest, prices rose by roughly 170 per cent in five years and the annual dynamics continue to be strong. The Home Purchase Subsidy for Families and the prenatal baby support loan may substantially transform the household market. According to the latest data, the share of these products already reached 40 per cent within new loans. The following issues were raised in the topic: How easy is it for the public to obtain a loan in the current situation? Can the range of customers eligible for bank loans broaden? Can we expect a sharp rise in housing loans? Do banks experience any overheating on the housing market? The banking sector increasingly supports the realisation of the economic policy objectives both on the corporate and household markets. What role may the public schemes play and what kind of realignment can we expect on the household market as result of this? In the past, it was essentially the affluent clients and those with large, regular incomes who were eligible for mortgage loans; however, the Family Protection Action plan broadens the range of borrowers. In connection with the prenatal baby supporting loan, an additional major upswing may be expected in retail lending, which, however will reduce the borrowing of personal loans. It can be said that today it is easy to get a loan in Hungary, and the lending process is increasingly quick; however, in Budapest prices are already so high that it may cause a problem. In connection with the housing market and mortgage lending, it is important to know how many buyers purchase flats for investment purposes and whether they compare the yield and the risk with the yield of government securities. Some believe that house purchase for investment purposes is already declining now. The banking sector found it a challenge to accustom the population to fixed-rate loans.

After this, the expected impact of the *Bond Funding for Growth Scheme* (BGS) was discussed. The MNB set a facility amount of HUF 300 billion for bond purchases, and it purchases bonds only with a rating over B+. Up to September, 125 companies reported their intention to participate in the Bond Funding for Growth Scheme; half of the registered companies have their registered office outside of Budapest. 81 per cent of the companies financed by banks have a PD value (probability of default) belonging to ratings of B+ or higher. Today, BGS is one of the most important capital market stimulation programmes. It is necessary, because the Hungarian bond market has a substantial lag even within the CEE region. The bond market represents a good transition between loans and the stock exchange. A company can get used to being rated, it can learn that it must think for the long term, and thus a bond market rating and a bond issue are a good entry path to the stock exchange. At the same time, further capital market deepening is essential. Bank executives believe that the facility amount of HUF 300 billion will be exhausted in a short time. BGS plays an important role in reducing the underdevelopment of Hungarian bond market, while bonds may be regarded as long-term, safe liabilities. Roughly 400–500 domestic enterprises, with B+ ratings that are eligible for listing, can be expected. The possibility of a guarantee, securing the corporate bond, also came up as an issue for consideration.

FinTech was the next exciting topic for discussion by the banking executives, with the title "*Synergy and/or risk?*". In the Hungarian banking sector there is still plenty of room to boost digitalisation, since digital maturity can still be deemed low, and Hungary – which lags behind the digital champions, such as Estonia, but even behind the intelligent followers, such as e.g. Finland – can be still classified as a "user" (preceding e.g. Slovenia, which is part of the "latecomer" category). FinTech solutions have an increasing user base globally, primarily in the area of payment services and insurances. At the same time, the FinTech solutions used globally by digitally active consumers have expanded sharply since 2015 also in the area of savings, investments, budgeting and financial planning, and lending. On the whole, it can be stated that in the area of payment services FinTech companies are already major competitors to the traditional actors and are also becoming increasingly attractive in the area of insurance and investments. The new FinTech companies are not complex banks, but rather appear only in certain banking segments. Today, customers have still greater trust in banks, although FinTech companies can access their customers more easily. Branches without personal service are also popular, but a personal relationship is still important for many, particularly in the countryside. The transaction levy is a key competition issue with FinTech companies, since if they are exempted from the rules of mandatory payment of the levy, applicable to banks, it may lead to unequal competition conditions. Regulation also plays an outstanding role in the area of avoiding supervisory arbitrage. All in all, banks need to adopt FinTech solutions and digital technology, as these offer great opportunities. At present, several banks are conducting negotiations for the involvement of FinTech companies, since they see the opportunity of automating as many functions as possible and having digital solutions through cooperation with them. The sales process must be shortened, but this is also conditional on banks' access to various databases. Alipay was mentioned as an example, which extends loans to entrepreneurs within a matter of minutes, applying artificial intelligence. At the same time, Márton Nagy also emphasised the importance of cyber security.

The last topic of the banking executives' discussion was *the effect of the Hungarian Government Security Plus* (MÁP+) *on the banking sector.* It was mentioned that the Treasury's share in sales is still low, i.e. below 30 per cent. More than 70 per cent is distributed by banks and brokers. For the government, the ratio of new funds reached 53 per cent, while the rest of it includes funds from the redemption of previous government securities. Purchase for cash accounted only for 10 per cent of the issues. Until 2023, sales by banks generates a cost of at least HUF 175 billion for the government and households, and this does not include the proprietary portfolio, i.e. the extra cost of "double financing" government debt. *Márton Nagy* believes that the current sales structure of household government securities should be revised. According to the banking executives, it would be unfavourable for the banking sector if in the future MÁP+ could only be sold by the Treasury. MÁP+ also absorbed funds from the real estate funds, other investment funds and bank deposits. Banks' proprietary MÁP+ portfolio is negligible, and in respect of this the Government Debt Management Agency prescribed a call option, and thus it is the decision of the Government Debt Management Agency, rather than of the bank, when it "asks for it back". At some of the banks, government securities can be purchased free of charge. All in all, MÁP+ is a successful product, generally recommended to clients by bank advisors. In relation to social responsibility it was mentioned that a well-functioning banking sector may lead – through economic growth – to an improving government debt path, and in addition, banks pay banking tax and transaction levy, through which they also contribute to the reduction of government debt.

The topic of the second panel discussion was entitled "*Prospects for the capital markets in light of the 2019 regulatory change*s". The role of the moderator was fulfilled by *Gergő Szeniczey*, the MNB's Executive Director for Prudential and Consumer Protection Supervision of Money Market Institutions, while the participants included *Károly Régely,* Managing Director of Concorde Értékpapír Zrt., *Róbert Cselovszki,* Chairman and CEO of Erste Bank Hungary Zrt., *Bálint Szécsényi,* Managing Director of Equilor Befektetési Zrt., *András Temmel,* Secretary General of the Association of Hungarian Investment Fund and Asset Management Companies, and *Richárd Végh*, CEO of the Budapest Stock Exchange.

In the past period, a number of EU-wide regulations were published, of which it is worth mentioning MIFID II, which is of the utmost importance for investment service providers and affected the fund management market probably the most. At present, a number of proposals are being negotiated, as a result of which in the future presumably additional legal norms related to the capital markets may arise. Topics of the most important proposals: EU framework for hedged bonds, facilitation of the cross-border distribution of collective investment funds, more proportionate and more efficient rules affecting investment firms, easing access for smaller companies to capital market financing, strengthening the oversight of central counterparties, and the community financing framework. Market participants perceive the major changes in the past period as a "regulatory tsunami", which represents a great challenge for the specialists. This includes, among other things, tightening the statutory requirements related to contact between service providers and clients. The smaller, independent companies are in a particularly difficult situation, which is further exacerbated by the shortage of experts. Some were of the opinion that the market was overregulated. As a result of the regulation related to money market funds, the role of these funds became marginal in Hungary. Clients coped well with the situation, the attitude of the Hungarian financial supervisory authority was supportive and proactive, and the fact that the regulatory processes took a consultative nature supported adjustment.

In relation to the capital market development strategy, it was mentioned that there are major reserves in capital market financing in Hungary, but also in Europe, compared to the North American and Asian capital markets. At the EU level, the market capitalisation of the listed companies reaches 100 per cent of GDP, while this ratio is 20 per cent in Hungary. The five-year strategy of the Budapest Stock Exchange has set the goal of doubling market capitalisation in Hungary. At present there are 300–400 companies in Hungary eligible for listing, which need major capital for their growth.

The bond portfolio of non-financial corporations as a percentage of GDP is at a lower level than in the EU, and thus the MNB's bond scheme, with a facility amount of HUF 300 billion – launched on 1 July 2019 – is particularly important, as it contributes to the diversification of corporate funds.

The online "budget" products, i.e. the prevalence of FinTech applications via sophisticated personal customer service, was an important topic. The appearance of Roboadvice changes the previous vision. FinTech companies revamp investment services and the market for the distribution of investment funds by their low costs and standardised solutions, but at present personal relations and particularly the existence of trust is still a key factor for many investors. The Hungarian service sector can be deemed successful in the application of FinTech solutions.

Bonds related to sustainability were one of the key topics discussed by the panel. Regarding attitudes on sustainable development and investment vehicles, it was mentioned that the variety of green products is extremely wide globally, starting from green bank accounts and recycled, biodegradable bankcards through the various green loans aimed at enhancing energy efficiency to derivatives related to carbon emission quotas. Consumers may meet green products primarily on the capital markets, but at present there is no uniformly approved definition and European framework for green investments and green products.

The third topic of the section was *fostering the instant payment system* (IPS) *and electronic payments.* The moderator of the panel discussion was *Lajos Bartha*, Executive Director Financial Infrastructures and Banking Operations of the MNB, while the participants included *Tamás Kovalovszki*, Director of K&H in charge of daily finances, deposits and investments, *Tamás Foltányi*, Managing Director of Erste Bank Hungary Zrt., Deputy CEO in charge of IT and Operations, *Mihály Veres*, CEO of Nemzeti Mobilfizetési Zrt., *Ákos Kalmár*, Deputy CEO of T-Systems Magyarország Zrt. and *Eszter Hergár*, the MNB's Director for Social Relations.

Lajos Bartha demonstrated that in Hungary payments are still dominated by cash. More than 80 per cent (in 2017: 84.8 per cent) of retail payment transactions were conducted using cash. This has major disadvantages: high social costs, tax evasion, and the informal economy. In the next step the key features of the instant payment system, to be launched in March 2020, were presented: operation will be continuous 24 hours a day, including weekends and bank holidays. The limit for domestic forint credit transfers is below HUF 10 million, the time limit for execution with the use of secondary identifiers is 5 seconds, in the course of which instant clearing and settlement will take place. Request for payment will be available, while the sending of positive feedback is optional and the sending of negative feedback is mandatory. The system is characterised by open standards and interoperability. The IPS may be supplemented with value-added smart services (e.g. open banking, i.e. PSD2), the development of which is expected by the MNB from the banks. The largest value added in the instant payment infrastructure is represented by the request for payment. The auxiliary services that may be built on this include the payment of monthly bills and services for monthly fees, the replacement of postal money orders, purchase, blocking and limit management in the case of non-time critical transactions, the management of payment due dates and due date reminders. Market participants expect the regulators to be flexible and constructive, as auxiliary services improving the efficiency and the acceptance of ISP may only be implemented in this way.

The opportunities to use instant payments are wider than those of the present card payments or credit transfers, since it permits on-site payment for products or services, which is important particularly for time-critical transactions. This means that it can serve as an electronic alternative in all payment situations where at present the only solution is cash. The transfer of money directly between private individuals is an outstanding opportunity. In addition, there are a number of traditional functions, such as shopping at physical points of acceptance, payment of bills or online shopping. However, the advantages inherent in instant payment can be fully realised only if based on it widely usable innovative payment solutions are available for households and businesses. The MNB provides support for the development of interoperable auxiliary services based on open standards (secondary account identifier, request for payment message, guidance for the payment processes in certain payment situations, QR code standard).

In technical terms, the question of security bears the utmost importance also in relation to instant payments. There will be no time in the individual transactions to examine whether or not there is fraud; however, artificial intelligence will be able to decide this in a matter of seconds. Technology must now be implemented that has never been created or used by anyone before. It will be also a key question how fast instant payment can spread in the merchant chains.

For actors in the banking sector, access to critical mass is an important business issue. This will be achieved when the services attract new digital clients from the formerly non-digital customer base. There are successful examples of this, such as Sweden or China, but there are also negative ones, such as Italy and Belgium, where value-added services were launched, but insufficient numbers of customers switched to the new services. In Hungary as well, it will only be successful after 2020, if interpersonal services spread quickly.

Eszter Hergár noted that – simultaneously with the start of the instant payment system – the MNB will launch a wide-ranging social information and educational campaign. This supports the national strategic programme, announced by the government eighteen months ago, aimed at enhancing the financial awareness of the population. The sixth part of this seven-point strategy is to foster the use of modern, cashless payment instruments. The MNB ordered surveys, according to which the key considerations of households include price, transparency, flexibility and security; accordingly, in the competition commencing from March 2020, consumers will make their decisions based on these criteria. However, the shift in attitude takes place extremely slowly, since this is also a question of culture. In order to raise the awareness of young people, the pilot programme entitled "Cashless Schools" was launched in 15 schools, based on the experience of which, another 250 schools would like to adopt the programme. It is also of paramount importance that instruction in basic financial and economic skills be started in primary schools as well.

The instant payment system, as an electronic means of payment, will also contribute to the reduction of cash payments, but Hungary is still very far from being a cashless economy. By 2030, half of all payment transactions may be electronic, as electronic payment turnover may increase substantially over the next 10 years. The goal is that in 2030 the ratio of electronic payments should be around 45–50 per cent. This can be achieved with 200 million new electronic payments annually. It should be mentioned that – in technological terms – the financial sector is ready for this already even now; however, obviously there are certain social groups in the society for whom cash is still important.

All in all, we can say that implementation of the IPS is also important in terms of competitiveness, since in the absence of this banks would lose customers.

The topic of the last panel discussion of the section was the *experience gained from the launch of the Bond Funding for Growth Scheme*. The moderator was *Viktória Nagy*, head of the MNB's Structured Finance Strategy Directorate and member of the Presidium of HEA's Financial Section. The participants were *Balázs Bíró*, partner at Deloitte and head of the CEE financial advisory business, *András Kazár,* executive of OTP in charge of capital market advisory services, *Kinga Oravecz*, department head at ERSTE Bank Hungary, and *István Máté-Tóth*, Deputy CEO of the Budapest Stock Exchange. *Viktória Nagy* said that in terms of its corporate bond market Hungary has a great lag both by European and regional standards. The primary purpose of BGS is to enhance the efficiency of the monetary policy transmission mechanism. In addition, the secondary goals are also important: BGS generates competition for bank loans, which may facilitate the development of a sounder funding structure. In addition, a suitably liquid and developed bond market may increase financial stability, in the event of a crisis it provides the central bank with the opportunity to intervene directly, speedily and efficiently, thereby mitigating the impacts of a future crisis, while gaining experience in capital market funding may also support the efficient realisation of the corporations' fund raising in the longer run.

The BGS framework relies strongly on the European Central Bank's corporate sector purchase programme (CSPP). The issuers of the bonds may be non-financial corporations with registered office in Hungary. The ratio of purchases by the central bank from each bond series must not exceed 70 per cent. Within the scheme the central bank may use a maximum of HUF 300 billion for the purchase of bonds, which amounts to 0.7 per cent of GDP. The currency of the purchased bonds may only be forint, the credit rating of the purchased bonds must be minimum B+, the agreed maturity may be minimum 3 and maximum 10 years, and the purchase may be executed both on the primary and the secondary markets. The size, activity and sector classification of the applicants to date is extremely heterogeneous and diversified and great interest is shown for the programme in all sectors. According to the September data, more than 145 companies registered for the scheme, while their combined balance sheet totals came close to 15 per cent of GDP. The credit rating reports of the companies that successfully passed the credit rating phase are available on the websites of the MNB and the rating agencies.

Market participants are of the opinion that it is important for the corporate bond market in Hungary to gain momentum, for the achievement of which BGS is a very good initiative. For corporations, the scheme is advantageous not only in terms of the diversification of their funding structure, but also as part of a learning process pointing to the capital market. The corporate sector received BGS very positively, with a large number of interested parties. They emphasised that BGS was launched at an ideal time, since yields are at a historic low. They believe that this external incentive was very much necessary to support the development of the Hungarian corporate bond market. According to the market participants who attended the meeting, roughly 100–150 larger companies may be able and eligible to participate in the scheme. Corporations regard BGS as an additional source of market funding, relying on which they may primarily increase their investments. The credit rating of the corporations and their bonds, and compliance with the prospectus represented a major, but manageable task for many of the applicants.

Although keen interest in the scheme was already observed before its launch, the participants of the panel discussion urged all companies contemplating a bond issue to learn about the opportunity provided by BGS and to take the first step as soon as possible, register in the registration interface on the MNB's website[1].

The Innovation section, which met in parallel with the money and capital market section, held its meeting in English, and thus in addition to the Hungarian speakers, foreign speakers could also share their views on Hungary's opportunities to foster innovation and the challenges hindering innovation. The section on the challenges of innovation commenced with the presentation of *Magdolna Csath,* professor of National University of Public Service and member of the National Competitiveness Council. Analysing the notion of innovation, she took stock of a country's innovation capacity and the position of Hungary in a European comparison of factors such as education and research, i.e. the basic conditions of innovation. The key conclusion of the presentation was that the two most important basic conditions of innovation are human resources and entrepreneurship. While investment in human resources essentially takes place through education and the improvement of healthcare, and results can be achieved through this, fostering entrepreneurship primarily depends on a favourable social environment. All in all, it is an essential condition of long-term development and progress that the economy should be based on innovation, which necessitates the continuous, lifelong development of knowledge and skills.

Thereafter *Anikó Szombati*, the MNB's executive director for digitalisation and the development of the FinTech sector made a presentation on why and how the MNB supports innovation in the financial sector. The baseline of the presentation was that – although the digitalisation of financial services and the channelling of innovative ideas and FinTech solutions to the operation of banks and insurers may offer major and tangible advantages to both clients and service providers – in Hungary market pressure alone is unable to enforce material changes in this area, and thus the encouragement and support of the MNB is also necessary. Within the scope of this activity the MNB places special emphasis on competition under equal terms, potential risks and consumer protection issues, to prevent negative, unintended side-effects from the spread of innovative solutions. The MNB's innovation platform, the Innovation Hub, and the new framework facilitating faster market entry, i.e. the Regulatory Sandbox, were created as a result of comprehensive work based on an in-depth survey of the FinTech ecosystem and market needs. Here, the MNB, in its capacity as the supervisory authority, provides financial institutions offering new products and services with the opportunity to test to what degree their ideas work and how customers receive them, in a controlled environment and on a small scale. In this way, risky schemes can already be identified at an early stage and it is also easier to convince policymakers if any legislative change is necessary for the purpose of applicability. In 2019, an independent executive directorate was set up

[1] https://mnbpoll.mnb.hu/Survey.aspx?surveyid=105083665&lng=hu-HU

with a view to emphasise digitalisation and FinTech support to a larger degree, and in autumn 2019 the MNB's detailed FinTech strategy was also published.

Participants in the panel discussion after the presentations included *László György*, state secretary of the Ministry for Innovation and Technology in charge of economic strategy and regulation and member of the presidium of HEA's General Government section, *Anikó Szombati*, *Kevin A. Murray*, CEO of Citi Hungary & CEE region, and *Ferenc Pongrácz*, executive director of Tungsram Group in charge of innovation and chairman of HEA's IT Section. The participants presented the innovation achievements of their own area, among other things, the industrial innovations at Tungsram Group, which fosters the spread of additional innovative solutions by using them in manufacturing and agriculture. We also learnt how global service providers such as Citibank are able to create innovation hubs and centre by concentrating their capital, one of which is the group dealing with cyber risks, headquartered in Budapest, but there are also other major centres engaged in FinTech development in Dublin and Tel Aviv. In addition to the foregoing, management of the 2010 economic crisis by the Hungarian government may also be regarded as an innovative approach, which – ignoring the formerly known scenarios – provided a fast and successful solution.

Of the messages of the panel discussion it is the importance of the government's role in fostering innovation which should be highlighted, since in Hungary the large number of small- and medium-sized enterprises is usually not sufficiently prepared to participate smoothly – either as supplier or partial contributors to researches and developments – in the innovation projects controlled by large companies. As Magdolna Csath also mentioned in her presentation, enhancing the quality of innovation, as one of the most important parts of competitiveness, is not only a question of money, as fostering entrepreneurship is equally important. This may also be supported by the state, if in addition to granting financial subsidies it also plays an active role in supporting information flows.