



MAGYAR NEMZETI BANK



Influence of Central Banks on the Stability and Development of Financial Systems in Transition Economies

Hungary - case study

Balázs Zsámboki

Head of Regulatory Policy Department

Warsaw, 8 October 2004

Chronology

Development of the Hungarian Banking Sector

1987-1991 establishment and crisis

1992-1994 crisis management and recapitalisation

1995-1997 privatisation

1998-2000 stabilisation

2001-2003 growth and integration

2004 - future financial stability challenges



Crisis Situation 1990-1991



- Deepening macroeconomic instability in the early years of economic transition
- Rigid ownership structure, with state dominance
- Inherited large amounts of bad loans
- High segmentation and lack of competition
- Weak management, inefficient operation
- Poor supervisory and legal framework
- Inadequate accounting rules

Consolidation Period 1992-1994



- Adoption of several consolidation techniques
 - Portfolio cleaning Figure 1
 - Enterprise oriented loan consolidation Table 1
 - Bank recapitalization
- „Legislative shock therapy”
 - Banking Act, Act on Accounting, Act on Bankruptcy, Securities Act, Act on the National Bank of Hungary, Act on Investment Funds

Bank Privatisation 1995-1997



- Banks were sold to strategic owners who can provide capital, technology, know-how
- Privatisation price well above face value
- Structure of foreign investors is diversified by country
- Largest retail bank privatised through the Budapest Stock Exchange
- In the second half of the '90s dramatic change in the ownership structure of the banking sector

Figure 2

Stabilisation 1998-2000



- Russian crisis - minor shock Figure 3 Figure 4
- Restored bank profitability, sufficient capital base, clean portfolios
- Improved management and quality of services, wider range of products and services
- Investments in information technology and branch network
- Increasing competition, falling margins

Role of MNB in promoting financial stability 1987-2000



- Lender of last resort function
 - Providing emergency liquidity for troubled banks
 - Easing reserve requirements (occasionally)
- Participating in the legislative process
 - supporting the implementation of the highest prudential and accounting standards
- Developing the payment and settlement systems - introducing the RTGS in 1999
- Gradually pulling out from direct or indirect commercial banking activities

Role of MNB in promoting financial stability from 2001



- Micro-prudential analysis (HFSA)
 - Establishment of an integrated supervision, 1999
 - Credit and market risk regulation and supervision - in line with EU standards
- Macro-prudential analysis (MNB) Text 1
 - Explicit financial stability mandate from 2001
 - Taking part in IMF-Worldbank pilot FSAP in 2000
 - Publication of the first “Report on Financial Stability” in August 2000 Text 2

MNB's main financial stability functions and instruments



- Financial stability tasks:
 - Macro-prudential analysis
 - Taking part in drafting financial legislation
 - Oversight of payment and settlement systems
 - Central bank inspection (payments, minimum reserves, statistical data)
- Instruments:
 - Payment system operation and regulation
 - Crisis management, lender of last resort
 - Only for systematically important banks
 - Communication

Figure 5

Regulatory policy - main tasks and activities



- Taking part in drafting financial legislation
 - Cooperation with the MoF and the HFSA
 - Emphasis on promoting financial stability, a sound and effective financial system and a level playing field
- Formulating the central bank's regulatory policy opinion
 - regulatory research, impact studies
 - publications on Basle II, consolidated supervision, dynamic provisioning, financial conglomerates, corporate governance, e-money, cross-border financial services etc.

Financial Stability Challenges after EU Accession



- Growing importance of interactions between financial and macroeconomic stability
 - Limiting excess „hot money” inflows
- Investigating the effect of competition on banks’ performance
 - Measuring the net effect of higher competition and consolidation on financial stability
- Monitoring market and credit risks of the banking sector
 - Improving our stress test models
- Regulatory challenges



MAGYAR NEMZETI BANK



Thank you for your attention!



Figure 1: The Cost of Bank Consolidation in Hungary

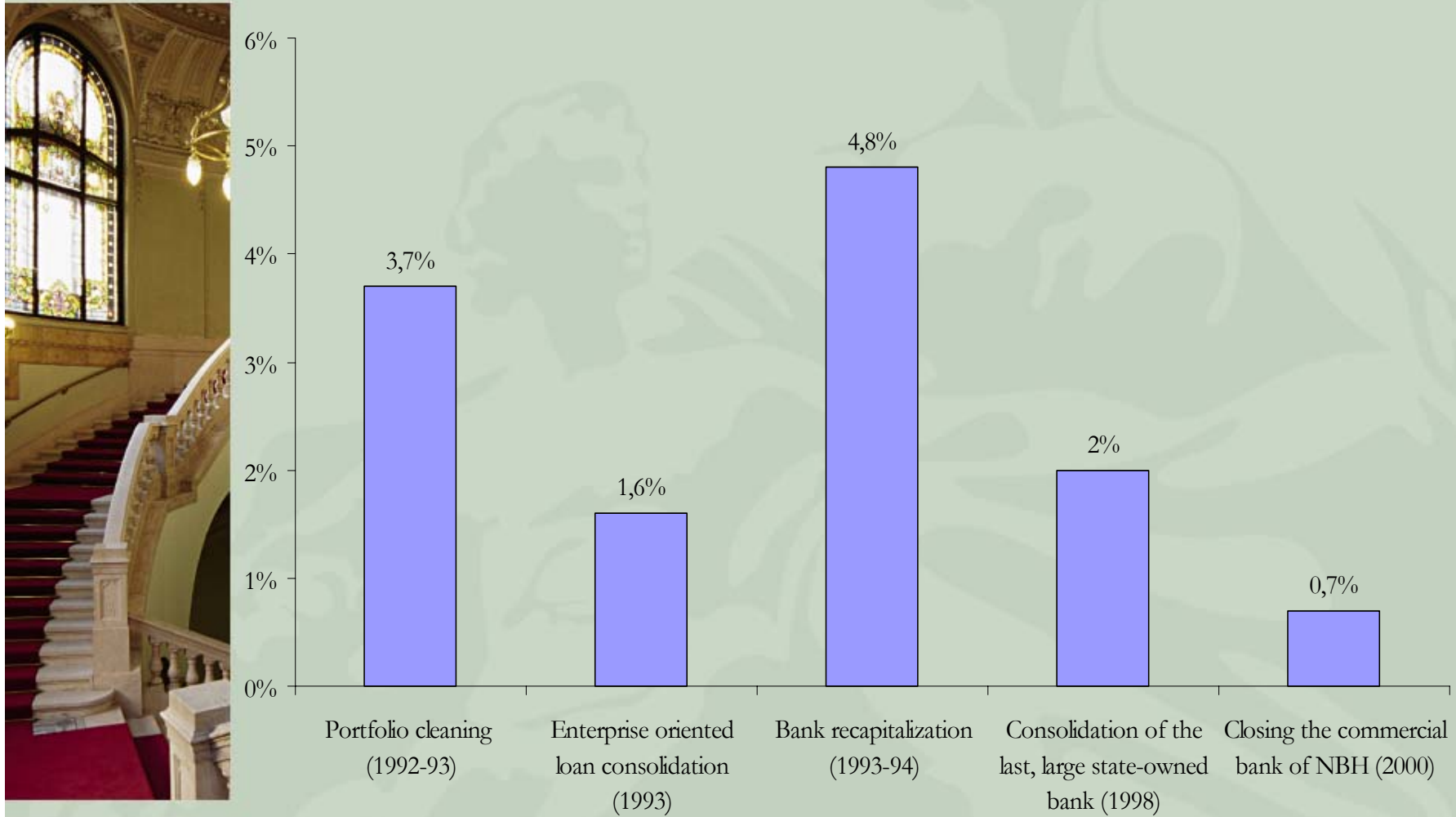


Table 1: The Cost of Bank Consolidation in Selected Countries



| Country | Percent of GDP |
|-----------------------------|----------------|
| <i>Latin-America</i> | |
| Argentina (1980-82) | 55% |
| Chile (1981-85) | 41% |
| Uruguay (1981-84) | 31% |
| Venezuela (1994-95) | 17% |
| Mexico (1994-95) | 12-15% |
| Brazil (1994-96) | 5-10% |
| <i>Asia</i> | |
| Thailand (1997-) | 35% |
| Indonesia (1997-) | 33% |
| South-Korea (1997-) | 20% |
| Malaysia (1997-) | 19% |
| <i>CEE countries</i> | |
| Bulgaria (1990s) | 14% |
| Czech Republic (1990s) | 18%* |
| Hungary (1991-2000) | 13% |
| Poland (1990s) | 6% |
| <i>Industrial countries</i> | |
| Spain (1977-85) | 15-17% |
| Japan (1990s) | 14% |
| Finland (1991-94) | 8% |
| Sweden (1991-93) | 4,5% |
| Norway (1987-89) | 4% |



Figure 2: Ownership Structure of the Hungarian Banking Sector

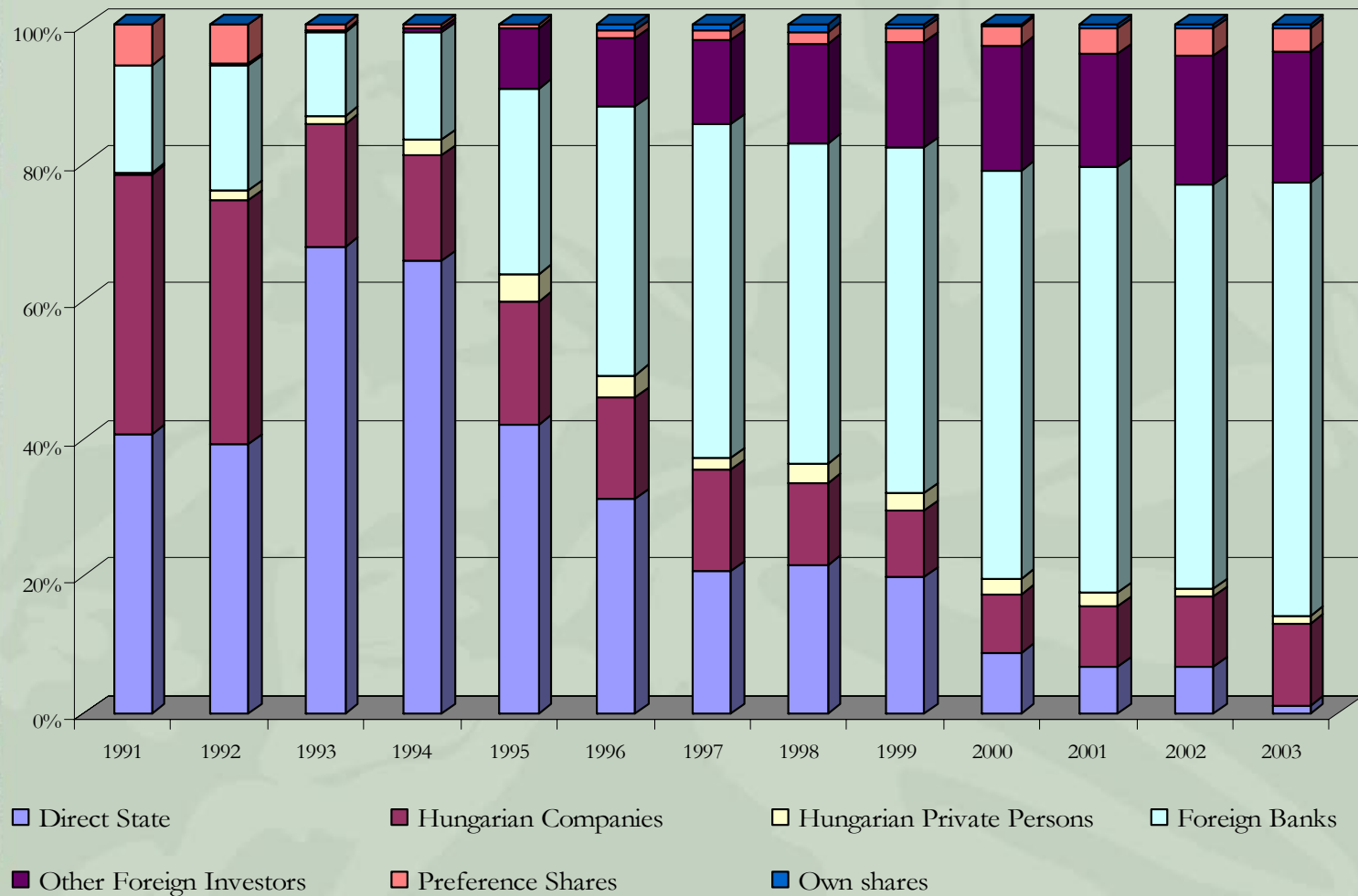


Figure 3: The CAR of the Hungarian Banking Sector

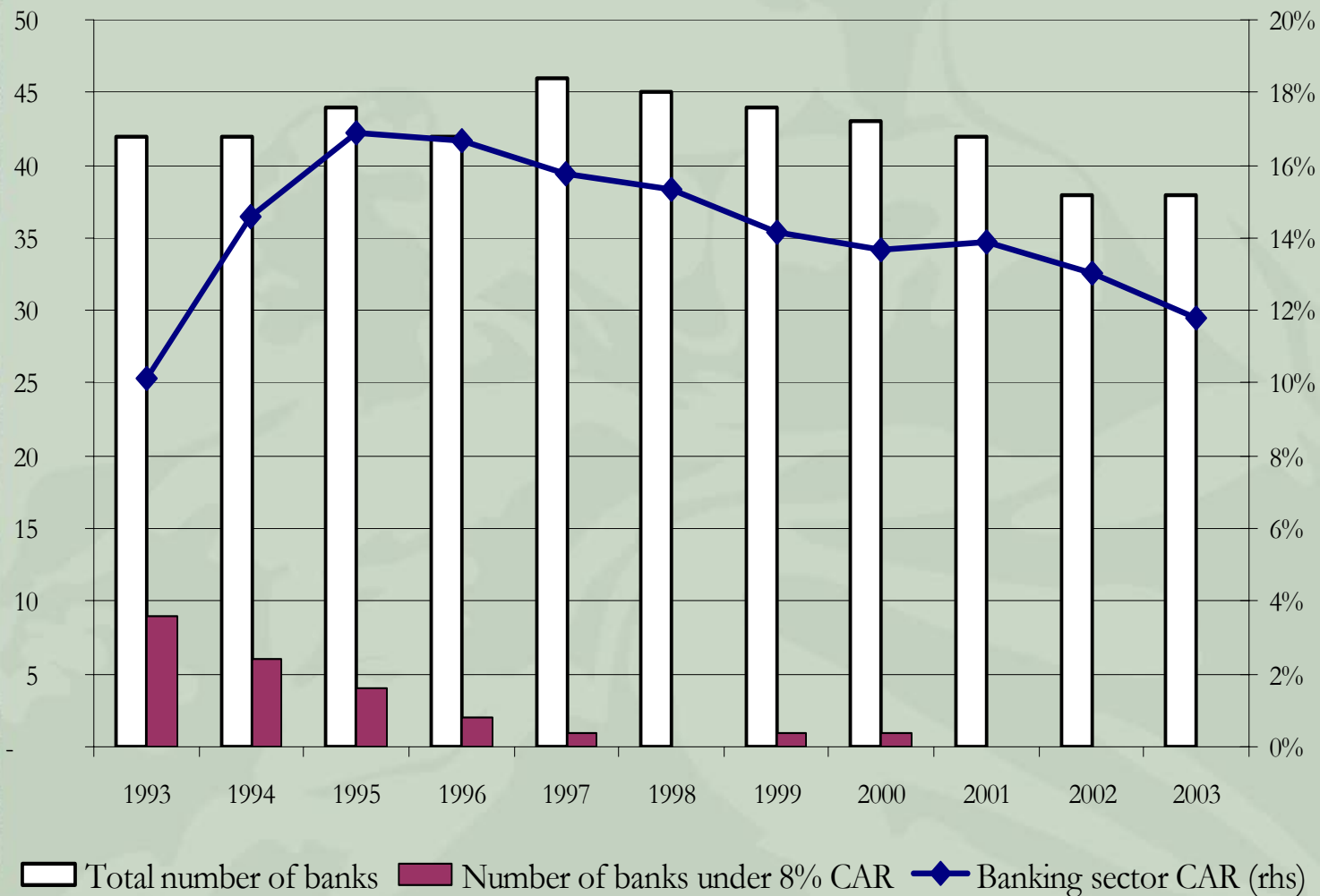
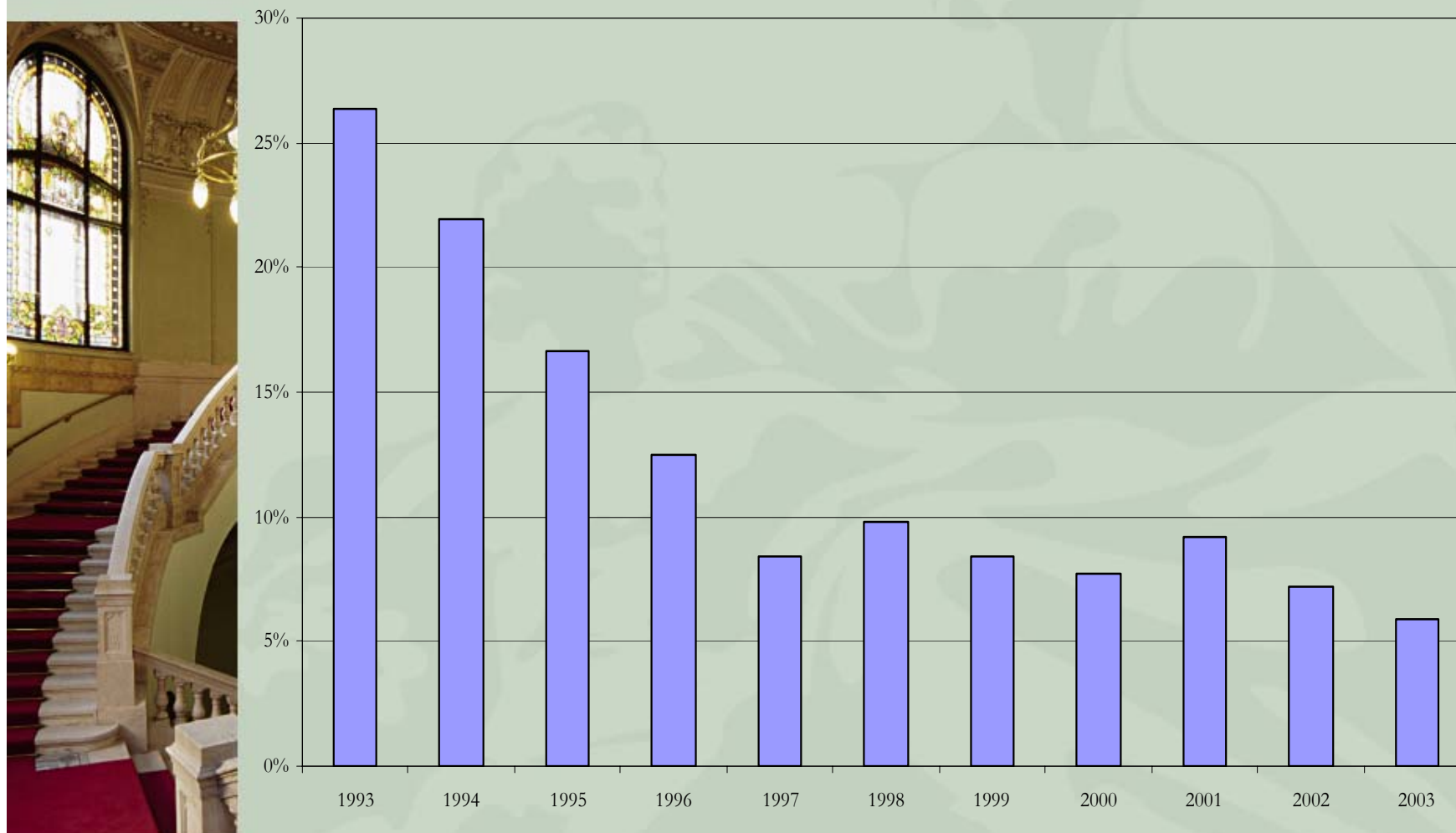


Figure 4: Portfolio Quality of the Hungarian Banking Sector



■ Qualified assets as a proportion of total portfolio



Text 1: MNB's Financial Stability Responsibility (CB law)



4.§.(7):The MNB shall promote the stability of the financial system and shall contribute to the development and smooth conduct of policies related to the prudential supervision of the financial system.

4.§.(5):The MNB shall develop and regulate domestic payment and clearing systems, and support the efficient and sound operation of these systems.

36.§.:The MNB shall be consulted concerning decisions and drafts of legislation related to the tasks and duties of the MNB and which affect the financial system.



REPORT ON
FINANCIAL STABILITY

JUNE 2003

Text 2: The purpose of FSR



“The purpose of this publication is to provide a comprehensive overview of the key issues directly or indirectly affecting the stability of the Hungarian financial system as well as to review and assess developments most relevant to the sector’s soundness or vulnerability”

Figure 5: Financial Stability Function in the MNB

