



Information Content of Hungarian Sovereign CDS Spreads

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Outline

- Facts about the Hungarian sovereign credit default swap market
- CDS spread vs. foreign currency bond credit spread: Primary market of the price discovery of Hungary's sovereign credit risk
- Information content of Hungarian sovereign CDS spreads: Recent developments in international comparison

The Hungarian sovereign CDS market

- Unregulated OTC market
- Credit derivative brokers, anonymous but mostly binding bids
- Active market participants: global investment banks, hedge funds, non-resident fund managers
- 5-year maturity, price quotes to nominal values of EUR 5-10 million, ISDA Master Agreement

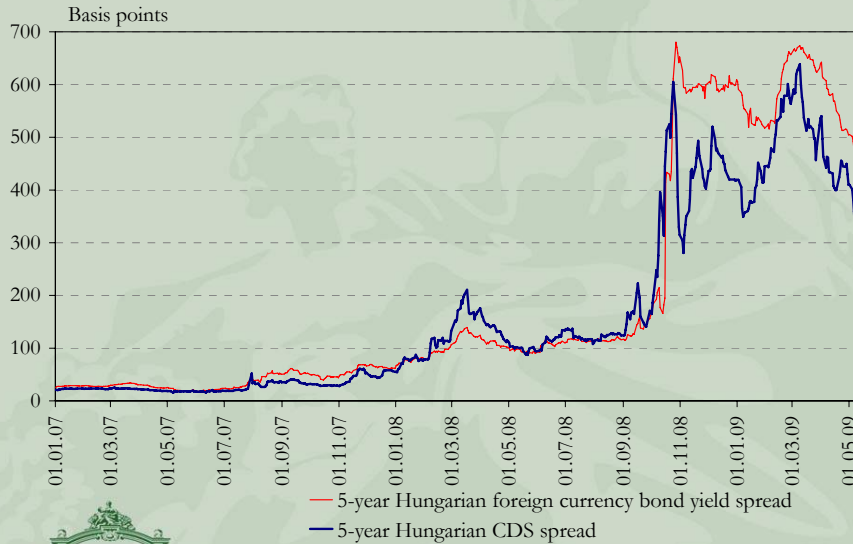


The Hungarian sovereign CDS market

- Adequate level of liquidity since 2005-2006, gradual turnover growth since early 2008
- In 2008: 30-40 binding price quotes daily from an average of ten banks
- More liquid than the secondary market of underlying Hungarian sovereign foreign currency bonds
- Gross outstanding stock of Hungarian sovereign CDS contracts:
 - End of 2007: USD 10-30 billion (own estimate)
 - October 2008: USD 33 billion (DTCC data)
 - Total outstanding amount of Hungarian sovereign foreign currency bonds at the end of 2007: USD 21 billion



Primary market of the price discovery of Hungary's sovereign credit risk



Primary market of the price discovery of Hungary's sovereign credit risk

	Cointegration (CDS spread and bond yield spread)	"Perfect" cointegration ($\beta=1$)	Primary market (Error correction)
2008-2009			
Hungary	YES	NO	CDS
2008			
Hungary	YES	NO	CDS
Brazil	YES	YES	BOND
Republic of South Africa	NO		
Croatia	YES	NO	BOND
Latvia	YES	YES	CDS
Lithuania	YES	NO	CDS
Poland	YES	NO	CDS
Romania	YES	NO	CDS
Slovakia	YES	NO	CDS
Turkey	YES	NO	CDS
Ukraine	YES	NO	BOND

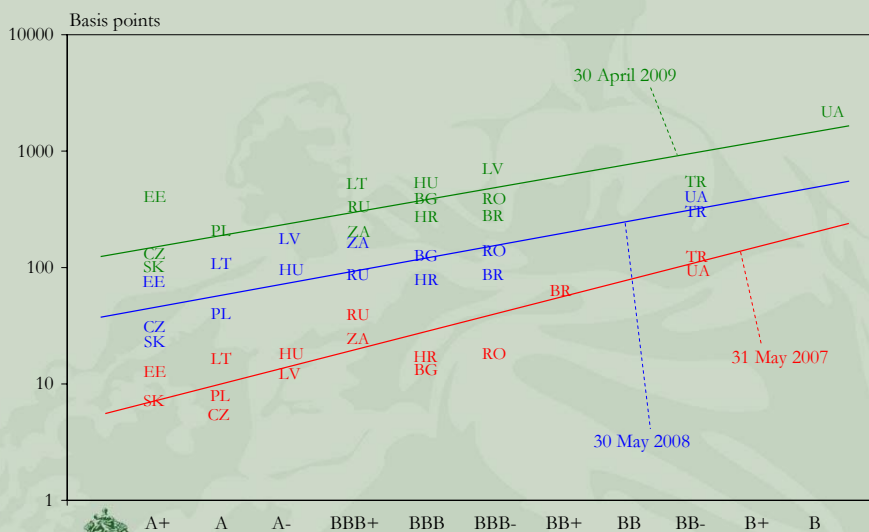
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Primary market of the price discovery of Hungary's sovereign credit risk

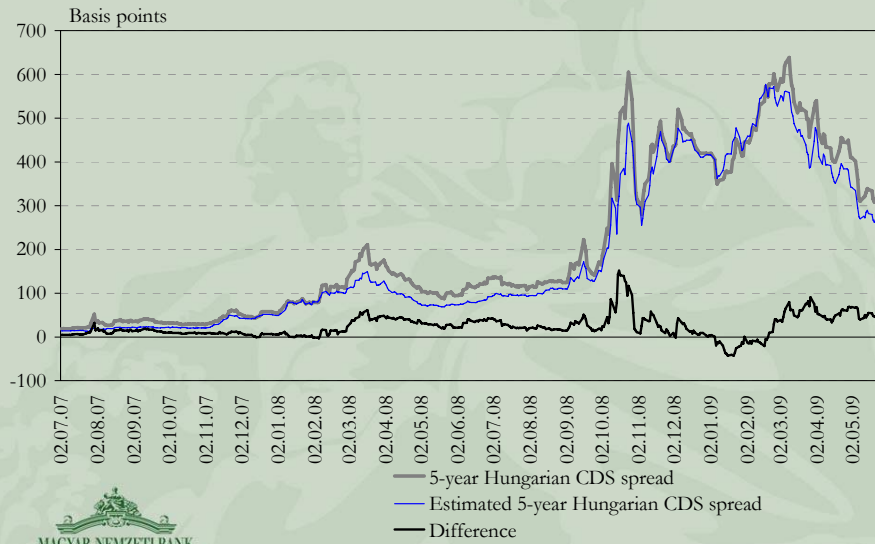
- CDS spread: Most reliable measure of the actual level of Hungary's sovereign credit spread
 - Wider foreign currency bond yield spread: significant increase in the level of the liquidity premium of Hungarian foreign currency bonds
 - After October 2008: Nearly 500 basis points increase in CDS spread
 - Country-specific or global factors?
- ↓
- Comparative international analysis of the 5-year Hungarian CDS spread (controlled for credit ratings)



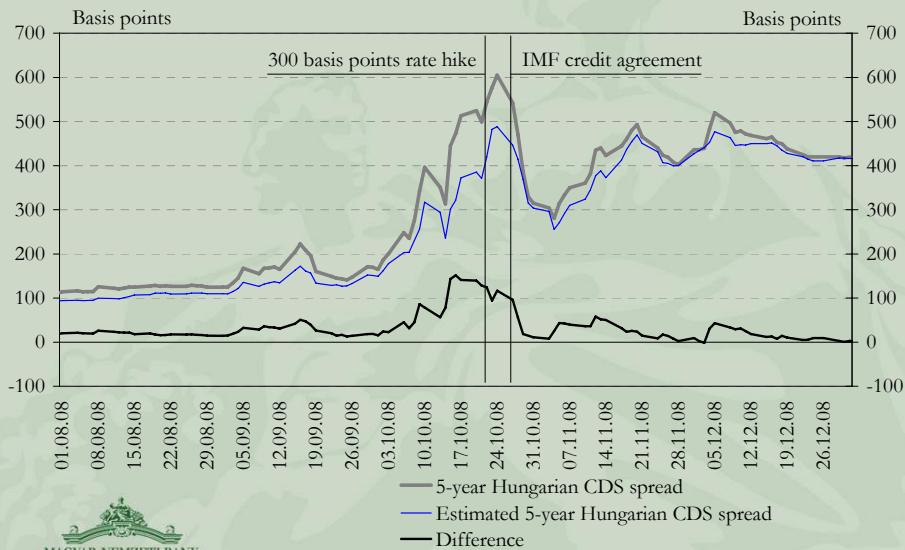
Recent developments in Hungarian sovereign CDS spreads in international comparison



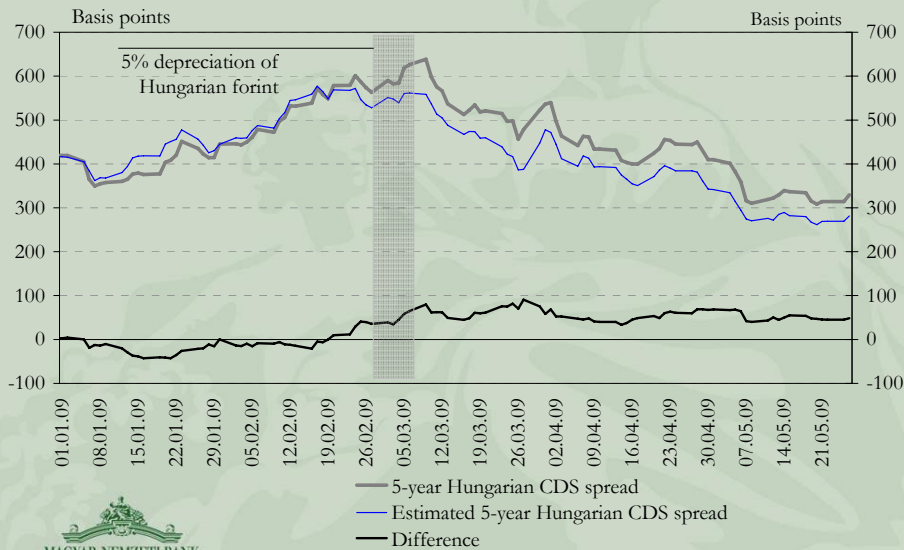
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Conclusions

- Despite the relatively low liquidity of the Hungarian sovereign CDS market the CDS spread is the most reliable measure of Hungary's credit spread
- In October 2008 country-specific factors significantly affected the Hungarian CDS spread:
 - Investors' perception of Hungary's credit risk was very unfavorable compared to other emerging countries
 - The extraordinary rate increase and the IMF credit facility agreement largely contributed to the stabilization
- From March 2009, the nearly 400 basis points decline in Hungarian CDS spread can be mainly attributed to the improving global risk appetite





Thank you for your attention!

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