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The Structural Outline of the Development and Consolidation of Retail Foreign Currency Lending

SUMMARY: The present essay presents the development of the exaggerated foreign currency borrowing of Hungarian households, as well as its sphere of responsibility and consequences. It touches on the consolidation processes that started in 2010, one of the main results of which was that the government of Hungary and the National Bank of Hungary (which implemented a new type of monetary policy as of 2013) saved hundreds of thousands of families from financial collapse. Across the world, as such in Hungary as well, neo-liberal economic policy turned to high-risk loans to compensate for its low efficiency and in fact in order to maintain its status, it also employed bank regulation instruments that allowed for the population to become overly indebted. The loan disbursement exceeding the population's solvency stems from the efforts to bridge the regime change that failed to bring economic-income convergence, as well as the globalisation of over-lending techniques that developed on the international stage and also reached Hungary.¹

KEYWORDS: Economics methodology, Household Behavior and Family Economics, Money supply, Credit Management, Finance Policy, Crisis Management

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HUNGARIAN DEBT TAXONOMY – WITH INTERNATIONAL CORRELATIONS

The lending to households that exceeds their creditworthiness, corporate indebtedness and countries falling into the debt trap are interrelated and intertwined phenomena which have represented one of the gravest problems in the world since the 1970s. In proportion to the world's gross domestic product (GDP), a marked increase of public debt can be observed since the mid-seventies, which increase took on new momentum from the 2000s: in 1970, the world's public debt-to-GDP ratio was 25 per

cent, but 35 and 70 per cent in 2000 and 2010 respectively.

By the 1990s, the public debt-to-GDP ratio of the United States has doubled from the late 1970's 30 per cent, and since 2010 has been permanently in excess of 100 per cent. The total debt of euro area member states is also close to 100 per cent of GDP (92.1 per cent at the end of 2014), which represents a rise of one third compared to 2000, however, the period before the current crisis was accompanied by very strong general growth. In this respect, it may be worth comparing France and Germany, two West European countries with vastly different public finance cultures and practices. France's public debt in 1981

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was approximately 20 per cent of its GDP, which jumped to almost 64 per cent by 2007 (at the onset of the crisis), then the debt ratio rose above 95 per cent as a result of the crisis. Germany followed a different path, but overall for many years the increase of debt was typical: the German debt ratio in the mid-nineties was at around 55 per cent, then rose to 65 per cent by 2007 and above 80 per cent by 2011². Naturally, the situation of the Eastern European region was different from that of Western Europe. Between 2004 and 2007, public debt in the majority of EU Member States in the region either dropped or stagnated, with Hungary being the only exception where the debt-to-GDP ratio increased by 31.7 percentage points between 2002 and 2010.

In the case of emerging countries that have switched economic systems, assuming they are indebted in foreign currency, exchange risk unavoidably arises, which – even at the original level of debts, converted to national currency – represents increased and in many cases unmanageable debt service. In the 1970s, performance problems, similar to those of other countries in the world economy, surfaced in Hungary as well. By 1979, total debt exceeded USD 10 billion. World economic events, the ripple effects of the oil crisis, alongside erroneous economic policy and an outdated economic structure all played a significant role in the continuous increase in loan volume. By the start of the political regime change, Hungary’s total external debt rose to USD 21 billion.

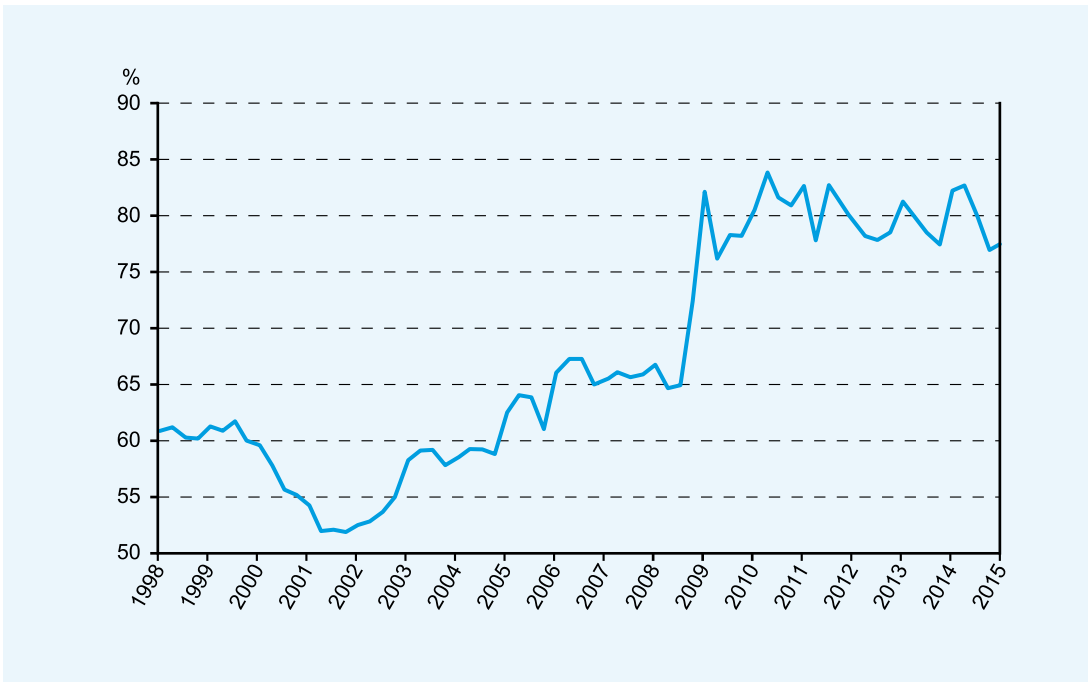
During the neo-liberal market economy transition starting at the end of the 1980s, Hungarian economic policy (subject to the core philosophy of the Washington Consensus and enforcing the demands of the IMF which pursued a similar ideology) carried out market economy reforms. As one of the results of this, the growing budget deficit became a permanent system-specific phenomenon³, and the austerity measures – in the spirit of the time –

serving to mitigate said deficit, along with the increasing use of foreign loans to bridge the deficit also became general characteristics of the Hungarian regime changing economy. The budget deficit and the accompanying public debt became unmanageable as a result of the government policy emerging as of 2002, the effects of which – in spite of successful fiscal consolidation carried out between 2010 and 2013 – are felt to this day.⁴ New governments after the turn of the millennium on the one hand overspent and on the other, enforced the taxation of international companies and banks below their actual tax capacity. Between the 2002 government change and 2010, the public debt-to-GDP ratio increased from 53.6 to 85.3 per cent. This in itself served as verification that the neo-liberal economic policy pursued up until 2010 could no longer be maintained. Meanwhile, between 2002 and 2010, debt volume swiftly accumulated both in the local subsystem of public finances and at the level of families, and became unmanageable by 2008⁵. The phenomenon that occurred in Hungary as well was that after some time, the public debt increase resulting from the neo-liberal economic policy, which only marginally impacts the economy, does not coordinate market players adequately and only regulates and audits to a slight extent, generated a decentralisation process, allowing, or in fact forcing local governments and the population to become indebted. (*see Chart 1*).

The beginning of the 1990s saw a significant decentralisation of tasks commence from the central budget sector towards the subsystem of local governments within public finances. The deployment of tasks, however was not followed by the decentralisation of central resources, especially not at real value, so by the turn of the millennium, there was a significant operating deficit in the local public finance subsystem. The decentralisation of deficit within public finances became a gen-

Chart 1

PUBLIC DEBT-TO-GDP RATIO IN HUNGARY, 1998–2015



Source: Based on MNB data, 2015

eral characteristic and soon afterwards the total debt of public finances also fell into a decentralisation vacuum. The value of total loan and bond volume increased from HUF 491 billion in 2007 to two and a half times this value, to HUF 1,247 billion by 2010. By 2008–2010, the neo-liberal economic philosophy that generated the debt also proved to be a failure at the second level of public finances. An immense and irrepayable, for the most part foreign currency-based debt volume was accumulated. Settlements took out loans in particular to ensure own funds of the EU investments that started in 2004.⁶

The deficit arising in the central and the local government system, the accumulation of deficit and public debt are the consequences of the inadequately organised operation of the state, which is an international phenomenon. In an environment where the state operates with low efficiency, it is unable to adequately

take care of its citizens and provide them with work and ‘expected levels’ of income. This is compensated at an increasing rate by the commercial banks’ retail loans ‘authorised’, regulated and tolerated by governments and central banks. As state operation weakens and as a result public debt increases, the debt volume held by households rises concurrently.

HOUSEHOLDS IN THE DEBT TRAP

Between 2004 and 2008, total US retail debt increased from USD 8,000 billion to over USD 12,500 billion⁷, and as a result of financial globalisation, this loan dynamic also became a general phenomenon in other countries of the world⁸. The household indebtedness process in Hungary was amplified by the permanent mood of Hungarian consumers ‘awaiting paradise’ and frustrated within the planned

economic system, as well as the fact that the regime change failed to bring about income convergence.

1.5 million employees were let go from Hungarian state-owned companies and large state farms that were ‘run into the ground’ by the time of and during the economic transformation. Their labour market integration has yet to be resolved to this day by domiciled international companies that have become the backbone of national economy production. Meanwhile, through the increased global presence, in other words the globalisation of financial, service provider and production companies, the favoured social models⁹, the ideal of the consumer society and the US model of financing consumption through commercial loans¹⁰ also became worldwide phenomena.

The neo-liberal economic policy and the resulting state operation with deficit and public debt which was also applied in emerging, developing countries, however, failed to raise the income levels of the people to the level of the ‘Western’ world. When examining this phenomenon in European Union Member States, the substantial difference between hourly wages in the private sectors of western core countries and eastern EU states (to the detriment of the latter) is striking to this day. In 2012, hourly wage in the EU 27 was EUR 23.50, compared to EUR 28.20 in the euro area. It was EUR 41.90 in Sweden, EUR 34.90 in France and EUR 31 in Germany. In Hungary this value was only EUR 7.9, but in countries to the east of us, in Romania and Bulgaria this was EUR 4.5 and 3.7 respectively. Hungarian incomes, therefore, were 72 per cent below the monetary zone average, and 81 and 74.5 per cent below Swedish and German labour wages respectively¹¹.

Meanwhile, the propensity of the Hungarian population to consume, and the nature, rate, target group and intensity of consumption is the same as that of the German or

Scandinavian societies. The social welfare system was meant to fill, or to be more precise reduce, the gap between wages and consumption needs, however, on account of the lack of funds, or even the deficit of the state and the local level, it is unable to fulfil this role. In order to bridge this gap, the missing solvent demand was supplemented by the commercial bank system (which also started shifting towards the retail segment on the Hungarian money market) through its special foreign currency loan packages. The propensity to consume was not satisfied by labour-based incomes, but rather by way of loans.

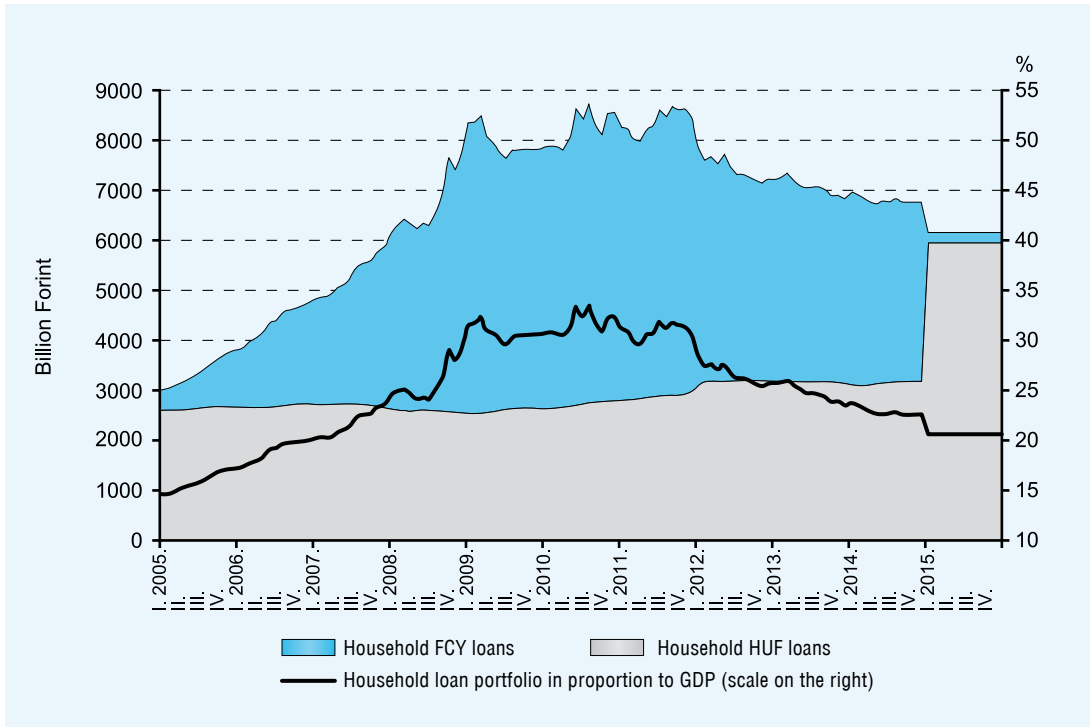
In the unstable state financial environment between 2002 and 2010, the total cash and deposit volume held by the population increased by 95.6 per cent¹², while its loan portfolio expanded to five and a half times its former size and edged close to HUF 11 thousand billion¹³ – while a ‘solid’ inflation path was in effect in the interval between 3.5 and 7.9 per cent. When examining the key components of the retail loan portfolio we find that the value of freely usable mortgage loans increased from HUF 388 billion in 2005 to HUF 2,556 billion in 2010, which is more than six and a half times more than the former value. Consumer loans provided to households increased by 495 per cent between 2004 and 2010. Of the HUF 3,130 billion recorded in 2010, 68.4 per cent was in mortgage loans. Foreign currency lending played a significant role in Hungarian retail lending. See data in *Chart 2*.¹⁴

In addition to lenient state regulation, the tipping of interest rates in favour of foreign currencies also played a major role in the foreign currency indebtedness of the retail and the local government sectors.¹⁵

As a result of the international financial crisis, it was primarily the weakening of the forint against the Swiss franc and the euro that increased the repayment instalments of households, local governments and companies indebted in foreign

Chart 2

THE CHANGE IN THE FOREIGN CURRENCY EXPOSURE OF HUNGARIAN HOUSEHOLDS BEFORE AND AFTER CONSOLIDATION (2005–2015)



Source: Based on data from the National Bank of Hungary, 2015

currency¹⁶, which at a time already burdened by high unemployment and low wages and in an indebted public finance environment was particularly shocking. The basic problem of foreign currency lending implemented in Hungary was that it lacked self-restraint on both the supply and the demand side and it disregarded the borrowing capacity of debtors.

RESPONSIBILITY TAXONOMY AND RISKS – LOST ILLUSIONS

The problem of state, local government and household indebtedness beyond general loan dependency occurs when the foreign currency revenues of debtors dry up or if they have no such revenues at all and repayment

is due. In such cases, repayment in foreign currency (especially if this happens during a time when national currency is depreciated) places considerable debt service and surplus cost coverage burdens on debtors. The foreign currency indebtedness of the Hungarian state in the socialist planned economy caused difficulties on account of the weakening of the export performance of industry and agriculture¹⁷. Local governments or the population had very little foreign currency-based revenues, practically none actually. Loan repayment after the expiration of the grace period greatly impacts the sustainable financial management of both the debtor and the creditor, with the failure to repay the loan generating chain-reaction-like instability effects in the national economy.

The status brought about in respect of lending is decidedly of a market nature. Loan demand, i.e. demand by those looking to borrow, appears and there are lending companies that provide loans. Looking at market nature, therefore, the credit market features banks as the embodiment of supply and households (with increasing needs) and other borrowers as the embodiment of demand. The state regulates and audits loan supply, loan dynamics and denomination through its macro- and micro-prudential authorities, or pursues the principle of not intervening or only to a minimal extent¹⁸ to manipulate or control the processes. It should be noted, however, that the state also bears primary responsibility for the failure to intervene into the operation of the market, as well as for the development and toleration of ‘autonomous’ lending processes that exceeded the borrowing capacity of loan applicants. The responsibility of regulation or non-regulation both fall upon the state. Non-intervention into market processes appears at the system-level in the operation of governments pursuing neo-liberal ideas and in that of their supervisory authorities, representing the essence of the given system. From US subprime markets to Central and Eastern European foreign currency loans denominated in Swiss franc, the system in each case collapsed due to inappropriate regulation. The crisis first hit market players where they were most vulnerable: household lending. The crisis followed from the of nature of the system and as a result there is more to it than a simple subprime mortgage market or banking crisis. We are faced with the crisis of the neo-liberal system, characterised by a lax stance towards market automatism, minimal regulation and supervision.

In addition to the weak regulatory and supervisory power of the neo-liberal system, banks are also responsible together with the families and households that embody the de-

mand side in that they took out loans and committed to repayment obligations far exceeding their realistically expected income revenues. Going back to the initial stages, the increasingly indebted governments are also responsible in that they operated under an economic policy scheme that was generating deficit and then laid down the regulatory framework that made excessive debt possible, while doing nothing to curb over-lending. Therefore, the roots of the local government and household debt problem are threefold,¹⁹ where the majority of the responsibility lies not with the demand, that is the loan applicants. The transition of the state into the role of a long-term borrower is²⁰ a direct consequence of the neo-liberal economic policies applied or of policies leading in that direction, and it is later also transferred to additional internal residents. The responsibility of the borrowers – who have a lower level of insight into the system and a limited understanding of how banks operate – is significantly reduced as a result of the communication of the authorities and the banks designed to mask the problems and their aggressive business policies aimed at credit expansion.

The base currency of the proliferation of foreign currency lending in Hungary was the Swiss franc. Foreign currency loans were concluded in the currency of the Alpine country that had not seen war for centuries and could attribute its wealth and affluence to its banks. The Hungarian population that is characterised by a low level of financial literacy saw security in the Swiss currency, which culminated in the strong escalation of foreign currency loans, due to the credit greed of the population and the lack of information provided by the banks. The regulatory activities of the governing powers that had already been in political crisis in 2004 and from 2006 onwards did not cover the assessment of the borrowing capacity and income earning capa-

bility of residential groups, did not establish conditions relative to the size of the collateral items pledged nor did they require banks to create such conditions.

The problem was further exasperated by the fact that these 10–30 year loans that were accounted in Swiss francs had no underlying banking funds²¹ for coverage for a corresponding 10–30-year term, or mainly Swiss franc denominated coverage on the liability-side, i.e. on balance sheet.²² In the critical period between 2004 and 2008, the monetary base portfolio of the Swiss franc barely changed, which may lend itself to the conclusion that the collateral side of the Swiss franc credit fever beginning to take shape in the Eastern European region, but mainly in Hungary – judging from the data provided by the Swiss central bank – could not have been covered with Swiss franc base money, controlled by the monetary authority.²³

A significant part of Hungarian households that took out foreign currency loans were not (would not have been) creditworthy in the domestic currency, which is why they would not have been granted Hungarian forint loans. On a side note, obviously there are no permanent, bank technical solutions that could turn an uncreditworthy client into a creditworthy one, not the least by changing the currency of the loan. This contradiction, however, was “successfully” overcome by the strong credit product sales campaigns of credit brokers, the outdatedness and laxness of credit underwriting indices, the business interests of the banks and – not insignificantly – the superficial judgment of credit hungry clients with regard to their own creditworthiness and the non-regulating state that was only interested in increasing (albeit only temporarily) the wealth of banks and their clients, all of which reinforced one another and turned a blind eye on each other’s faults. It has, however, been proven that long-term wealth and affluence

cannot be built from loans, not even at the level of households.

THE LOGIC AND RESULTS OF DEBT CONSOLIDATION

By the autumn of 2008, the total debt of the state, local governments and the population became unmanageable, in part due to the high volume of debt, and in part on account of the currency denomination of that debt. In the period after the summer of 2010, after the government change, the first round of measures focused on the budget and avoiding the collapse of the social security system. Fiscal consolidation was concluded by 2013, and Hungary was removed from under the excessive deficit procedure of the European Union.²⁴ It was in essence after this that the bailout process of foreign currency loan indebted local governments and households amplified²⁵, which process mitigated the default risk²⁶ of Hungary per national economy sectors.

In order to keep market players and the whole of public finances functioning, the Hungarian government took on a regulatory and supervisory role where it was able to directly influence financial conditions. The prevailing notion of the neo-liberal market economy model – which holds that market players are capable of self- and sectoral regulation, and creating balance – was replaced by the state playing an active part in the regulation of the economy. It regulates and supervises the operation of market players. It mitigates the enforcement of the Washington Consensus. It aims to increase national wealth, centralises control and manipulates market processes through state instruments.

The government curbs deficit and manages public debt with a fiscal policy aimed at sharing burdens. It integrated the debt rule into

the Fundamental Law and the subordinated cardinal acts. With the state consolidation of local governments between 2011 and 2014, the avoidance of national bankruptcy was extended to another segment of public finances. With and after this, in addition to ensuring general revenue increase for households, the state also took administrative financial measures aimed at reducing loan repayment instalments²⁷. The Hungarian government acted as consolidator in all three segments. In fact, apart from the assumption of local government debts and the state coordination of the repayment schedule and rate of retail loan instalments²⁸, by replacing the foreign currency loans of FCY indebted companies and by launching investment frameworks, through the Funding for Growth Scheme of the National Bank of Hungary²⁹, the liquidity situation of both debtors and banks improved. The Hungarian government eliminated sector bankruptcy threats in all areas (public finances, businesses, households) that previously made the operation of the state impossible, and as such also eliminated the threat of national bankruptcy.³⁰

The ultimate elimination of the collapse of the retail foreign currency loan segment also owed to the new type of corporate social responsibility programme introduced by the National Bank of Hungary. In the autumn of 2014, in order to phase out foreign currency-based loans, it created the possibility at central bank sale tenders – at the expense of foreign currency reserves³¹ – to convert consumer foreign currency and foreign currency-based mortgage loans to forint in a swift and organised manner.

At the end of September 2014, the total volume of consumer foreign currency and foreign currency-based mortgage loans in the banking system was HUF 3,350 billion (EUR 10.8 billion), which after the settlement with customers dropped by more than HUF 500

billion (EUR 1.7 billion). This means that the conversion to HUF impacted a debt volume of EUR 9 billion. At the same time, the booked loss in value behind the loan volume in question was more than EUR 1.56 billion (HUF 480 billion), of which, according to the MNB’s calculations, close to EUR 0.4–0.6 billion (HUF 120–180 billion) was released on account of the settlements. Consequently, the coverage required by the banks in relation to the conversion amounts to approximately EUR 8 billion. The EUR 7.83 billion allocated at the tender of the Hungarian central bank, therefore, means that the banks covered practically the whole of the foreign currency loan portfolio to be converted to forint. The central bank tender allows for the phasing out of consumer foreign currency and foreign currency-based mortgage loans.³²

The MNB’s foreign currency provision scheme was set up in a way that the banks’ foreign currency needs would be covered and in addition the optimal level of central bank reserves would not be endangered even if the limit amounts are fully utilised.³³ The guarantee for the latter is the fact that the instruments made available by the central bank on the one hand reduce short-term external debt, and as such the foreign currency reserve needs of the central bank; and on the other hand ensure that the banks fulfil the foreign currency demands arising from the conversion to forint through the appropriately spread out and gradual utilisation of foreign currency reserves, to be achieved in the next 3 years.

Foreign currency loans were actually and formally converted to forint in the spring of 2015. With their euro purchases, commercial banks covered the exchange risk stemming from the conversion, which is indispensable when it comes to ensuring the continuous operation of banks. In the case of the euro, the exchange rate was set at³⁴ HUF 308.97, and HUF 256.6 for the Swiss franc. Although

the exchange rates were higher at the phase-out than at the time of the start of these loans between 2002 and 2008³⁵, the objective of the government and the central bank was not only to bail-out household foreign currency borrowers, but also to bring banks to a consolidated financial position, meaning that the Hungarian public finance government implemented a complex consolidation underpinned by the Act on Fair Banks and the banks’ obligation to compensate clients for the losses suffered as a result of undue contractual amendments.³⁶

The fiscal and facilitating monetary authority cannot limit itself to consolidation and bailout activity in the future, or to the direct or indirect implementation of such activity. It is a fact, however, that the state also took out loans to finance its low efficiency operation that lasted decades (instead of taking out these loans for investments). Local governments and the population also became indebted in a neo-liberal, lenient and powerless market economy environment, due to products that failed to generate direct yield, the systemic nature of which environment produced state tax revenues and led to the reduction of wages, and as such also led to the prevalence of the ‘tendency’ to generate deficit and debt, even in terms of the population. The necessity of a mass bailout prior to collapse, however, is indisputable³⁷. The market players, families and local governments indebted in foreign currency loans are not primarily responsible for their indebtedness. In the neo-liberal financial environment, the institution or household in need of bailing out is not to blame for their bankruptcy, but rather the economic policy that brought about this situation³⁸. However, the government, stepping into a more active role, had to take responsibility for the institutions and social groups that were forced into indebtedness³⁹. To have applied a hard, bigoted, normative budget constraint against

bankrupt institutions and households, to have allowed them to become fully dysfunctional would have led to confusion in state operation and the dissolution of the social and subsequently the legal order. After having successfully concluded fiscal consolidation, the government came to the rescue of its other institutions and social groups.

EPILOGUE

On 15 January 2015 the National Bank of Switzerland gave up its protection against the volatility of the Euro exchange rate. As a result, the money and capital markets of the world experienced significant exchange rate volatility. The exchange rate of the Swiss franc against the euro “nosedived” from 1.2 to 0.8052 in a matter of seconds, while the HUF/CHF exchange rate soared from the 250–260 band to 378, peaking, for a short while – at private brokers – above 400.⁴⁰ Therefore, the removal of the peg strengthened the Swiss franc further, while significantly weakening the euro, and in particular the Hungarian forint, which could have had very grave consequences for Hungarian families and municipalities indebted in Swiss francs, had their state-led consolidation failed to take place.

Precedent: On 16 September 2011 the National Bank of Switzerland decided to cap the exchange rate of the Swiss franc against the euro at 1.2: meaning that the central bank started selling CHF when the exchange rate came close to the cap. Until the beginning of 2015, the Swiss national currency has been under constant strengthening pressure, which caused the euro amounts to continuously increase in the safe of the National Bank of Switzerland, while the euro exchange rate against the US dollar has deteriorated significantly. Therefore, in essence, the National Bank of Switzerland was able to avoid a further appreciation of the

franc by purchasing a depreciating currency. The implementation of the quantitative easing programme of the European Central Bank, rumoured since the summer of 2012, has become more topical than ever, which, however, would have brought about further euro depreciation coupled with a further appreciation of the Swiss franc. On 14 January 2015, the European Court of Justice decided that there were no obstacles to the planned bond issue by the ECB. Following the decision, it already seemed certain that the quantitative easing programme would be launched,⁴¹ while it was not in the interest of the Swiss central bank either to keep intervening *ad infinitum*, in other words, make sacrifices for the good of the European monetary area.⁴²

The discontinuation of the Swiss currency peg, in the event that the approximately CHF 20 billion exposure had remained, would have had catastrophic impact on the Hungarian lending market⁴³. Due to the elimination by the government and the central bank of household, corporate and local government exposure⁴⁴, however, the Swiss decision did not impact the majority of Hungarian market players any longer. In recent years, the Hungarian government and central bank consciously strived to reduce the foreign currency exposure of public finances, companies and households. The Hungarian public finance system proved its resilience.

The government and central bank effort aimed at the complete elimination of the retail foreign currency loan portfolio remaining after the conversion of mortgage loans to forint is also part of this. In the interest of the ‘bailout’ of car loan debtors indebted in foreign currency and those with personal loans denominated in foreign currency, in the summer of 2015 the MNB and the government reached a decision to convert these loans to forint too, which means that these retail loans, that are extremely dangerous due to the exchange risk and which consequently threaten financial and social stability, could be phased out from the Hungarian financial system for good.

The phasing out of foreign currency loans substantially decreases the external vulnerability of the Hungarian economy, which is in the interest of the national economy. This is strengthened by the reduction of the state’s external debt, which is also supported by the central bank’s self-financing scheme. The factors behind the reduction of foreign currency exposure include the consolidation of the public finance and household foreign currency loan volume, the discontinuation of processes that generate excessive budget deficit, the increase of the activity of the domestic population on the government securities market and the financing of public debt from within⁴⁵, in other words, the strengthening of self-financing⁴⁶.

NOTES

¹ This manuscript is an edited, expanded and updated version of the author’s book chapter entitled ‘A túlhitelezés globalizálódása a világban és Magyarországon’ (The Globalisation of Over-Lending Across the World and in Hungary) and his lecture entitled ‘Devizahitelezés: áldás vagy átok?’ (Foreign Currency Lending: Blessing or Curse?) delivered at the Ludovika Open University of the National Uni-

versity of Public Service. (In: A devizahitelezés nagy kézikönyve (The Comprehensive Handbook of Foreign Currency Lending). Nemzeti Közszołgálati és Tankönyv Kiadó, Budapest, 2015)

² This was followed by a slight adjustment, and by autumn 2014 German public debt dropped below 75 per cent of GDP.

- ³ As György Matolcsy put it: In the four decades between 1974–2014, one of the most typical traits of Hungarian economy was the lack of permanent financial equilibrium. Matolcsy, 2015. p. 15
- ⁴ Its impacts are felt to this day as our gross financing need as a percentage of GDP was 23.8 and 19.6 per cent in 2014 and 2015 respectively. In the same time frame, Egypt: 45.5–45.1 per cent, Pakistan 29.2–30.6 per cent. They are followed in emerging market economy rankings by Hungary. The closest to us in terms of values are Croatia and the Ukraine, with 19.7–19.3 and 16.4–16.3 per cent respectively. Based on IMF data.
- ⁵ In the autumn of 2008, Hungary was saved from sovereign default by the USD 25 billion loan provided by the IMF, the WB and the ECB.
- ⁶ For a detailed description of local government indebtedness and consolidation, see: Lentner, 2014 (Public Finance Quarterly)
- ⁷ As a result of the crisis, nominal decrease was observed until mid–2013, after which the retail loan volume started to increase slightly. At the end of 2014, American households owed in excess of USD 11,800 billion, which is still some 7 per cent less than the 2008 record high.
- ⁸ For more details, see: Lentner, 2013 Chapter 1
- ⁹ Open Society.
- ¹⁰ See: Lentner, 2013, Chapter 1
- ¹¹ On the government side, this is mitigated by the lowering of the personal income tax rate from 36 to 16 per cent, then to 15 per cent in 2016, as well as the freezing and subsequent reduction of household public utility fees from 2010 and 1 January 2013 respectively. The powers of the government impacting the development of gross wages in the business sector is limited, but it does wish to mitigate income disparity in respect of Hungarian and western wages through fiscal regulation that generates effective solvent demand.
- ¹² Data culled from MNB statistics.
- ¹³ According to data research using MNB household statistics, this is an amount of HUF 10,587 billion.
- ¹⁴ The chart clearly illustrates the effect of the statutory conversion to forint in 2014.
- ¹⁵ Besides the government and the bank supervisory authority, the former management of the central bank also bears considerable professional responsibility in the conditioning of interest rates and currency exchange rates at the time of the taking out of foreign currency loans. Monetary tools were available to align and bring closer interest rates that showed significant deviations.
- ¹⁶ The analysis of the indebtedness of companies is not a topic of this paper, but it should be mentioned here that the replacement of the foreign currency loan portfolio of the business sector with HUF loans – to a great extent – was implemented as part of the MNB’s Funding for Growth Scheme.
- ¹⁷ Especially because the loans taken out were, for the most part, not spent on producing exportable goods or were used to realise inefficient investments, or flowed to labour wages and state subventions with the aim of establishing full employment and financial security.
- ¹⁸ The free banking approach emphasises the independence of banks as market players, according to which market players are able to create equilibrium and avoid crises and market asymmetry. By 2007, this interpretation proved to be an utter failure in the United States and by 2008 in continental Europe and Hungary as well.
- ¹⁹ For more details see: Kolozsi – Lentner – Tóth, 2010 Also: Lentner, 2013, Chapter 1

- ²⁰ As the internal resources and reserves of the planned economy have started to run out, external borrowing started with the goal of bridging the resulting gap, which later entailed increasing pressure from the IMF and the WB to apply neo-liberal economic policy principles.
- ²¹ American subprime mortgages were often covered with short-term hedging transactions. The foreign currency denominated lending created in Hungary following that example meant that banks were unable to cover the disbursed loans with optimal funds either in terms of tenor or in terms of Swiss Francs, although, it is true that they did conclude other types of hedging transactions.
- ²² My subjective research concept: The shortfall in CHF coverage played a significant role in brining about the problems. Commercial banks did undoubtedly assign funding (albeit not in CHF) to over CHF-denominated loans, however, they did not assign optimally termed funding to appropriately cover these long-term loan arrangements, which created catastrophic problems for banks after the sudden increase in funding costs after 2007, after which banks tried to transfer the higher costs of acquiring these funds onto the borrowers.
- ²³ A complex explanation is provided in Chapter 1 of *The Comprehensive Handbook of Foreign Currency Lending*, Lentner, 2015.
- ²⁴ Hungary was under the EDP since 2004, that is for 9 years since the accession to the EU.
- ²⁵ To add to the household site: permanent retail foreign currency loan bailout packages and measures beginning in 2011 and the reinforcement of financial consumer protection represent consolidation by the state. On the other hand, the other (main) side of consolidation is the raising of income levels that are retained by households.
- ²⁶ For the areas of national bankruptcy threat and ways to avoid it, see Lentner, 2014 (*Public Finance Quarterly*).
- ²⁷ Prepayment, exchange rate cap scheme, holding banks accountable. Moratorium on evictions. Review of unfair contracts. Act XL of 2014 (the so-called Settlement Act), pursuant to which banks shall be obligated to settle with customers all overpayments due to the exchange rate spread becoming null and void and the unilateral contract amendments. The decree of the National Bank of Hungary (MNB) containing the detailed methodology of the settlement. It is worth noting that in addition to the review of the unfairness of retail loan agreements, the review of the unfairness vs fairness of local government loan agreements would also be justified.
- ²⁸ I consider the reduction of repayment instalments and the principal amount to also be part of state co-ordination.
- ²⁹ HUF 3,250 billion, which allows the refinancing of high-risk foreign currency loans and taking out investment and capital raise loans from the MNB’s refinancing facility. Another HUF 500 billion as part of the NHP+ to finance riskier SMEs.
- ³⁰ Obviously, there is no such thing as a finished, completed state in economic policy. Micro-problems arose in 2015 at the level of less regulated, so-called secondary banks: Buda Cash, Quaestor, Hungária Értékpapír, Széchenyi Bank and a few cooperative banks, which at the same time did not destabilise the banking sector.
- ³¹ The MNB’s foreign currency reserves as at 31 October 2014 was EUR 34,218 billion, which shows that there was (more than sufficient) coverage to bail out foreign currency debtor families. Source: MNB
- ³² For more on the conversion to HUF, see: Hoffmann – Kolozsi – Nagy, 2014
- ³³ Preferring conservative foreign currency provisioning, we consider the Guidotti–Greenspan rule to prevail. In Q1 of 2015, the EUR 37 billion of the foreign currency reserve was more than enough to

cover the short-term external debt that has been dropping since 2011, the value of which at this time was EUR 22 billion.

³⁴ Of the official daily exchange rate of the MNB on 7 November 2014 or the average exchange rate of the period since the decision of the Curia on 16 June 2014, banks must convert foreign currency loans to forint using the exchange rate that is more favourable for customers.

³⁵ The autumn of 2008 is not to be counted into this interval as the joint impacts of erroneous Hungarian economic policy and the global economic crisis ‘upset’ Hungarian money markets and exchange rates as of October 2008.

³⁶ Though the compensation provided to borrowers on account of the fair banking act and the unjustified, unilateral contract amendments is a financial burden on banks and limits the scope of their opportunities to generate raw profits, these acts actually lay the foundations for the ethical business management of banks, which foundations are essential for bank consolidation.

³⁷ At the time of the 2007 US subprime crisis, banks were bailed out en masse in the US. There were, in fact, even countries that were bailed out such as Hungary in 2008, followed by Greece, Cyprus, Spain, Ireland, or countries in the case of which further lenient fiscal policies were allowed (see France) in order to avoid total collapse. This is continued with the ECB’s QE asset purchase programme announced on 22 January 2015.

³⁸ I followed the very same logic when explaining the justification of local government consolidation, Lentner, 2014. (Public Finance Quarterly)

³⁹ My position on the enforcement of the soft budget constraint, which in this particular case argues for consolidation (the mitigation of damages caused by

the previous economic policy) and the implementation of this consolidation is in stark contrast with the views of János Kornai, who feels that the “SBC is a disease”.

⁴⁰ In the interest of mitigation, a decision was also made on a –0.75 per cent interest on CHF bank deposits, but that did not have a significant effect on the strengthening of the Swiss currency.

⁴¹ This indeed did happen on 22 January 2015, six days after the Swiss decision and eight days after the decision of the Court of Justice of the European Union.

⁴² The removal of the peg resulted in the strengthening of the Swiss currency, which is unfavourable in respect of export, though in the case of Switzerland this item is manageable and not really of primal importance, given the import and the near 30 per cent debt ratio, as well as the internationally dominant nature of its financial sector and the CHF.

⁴³ In my calculation, – assuming permanent panic effects – the CHF exposure would have resulted in an increase of liabilities of HUF 2,000 billion.

⁴⁴ The CHF 20 billion portfolio also includes the value of corporate foreign currency loans, the refinancing of which is made possible by the Funding for Growth scheme of the MNB. The exchange rate deterioration did not impact household EUR loans either as on account of the conversion to HUF these items no longer existed and, furthermore, the EUR loans of local governments were also consolidated by the state.

⁴⁵ Between 2010 and the beginning of 2015, the volume of government securities held by the population increased five-fold.

⁴⁶ For more details, see: Hoffmann – Kolozsi 2014, Kolozsi 2014

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