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Hungary Economy briefing:

Financial Stability in Hungary

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Financial Stability in Hungary

In our earlier briefings on economic trends in Hungary, we drew attention to the importance of global financial tensions that have been building up in the world economy over the recent months. In our opinion it is worth discussing the development of economic fundamentals and financial conditions in the Hungarian economy in this briefing and looking at the different elements of this issue; f. ex. how stocks of savings and loans have developed in the private households and non-bank firms, and what are the main trends and basic conditions regarding public debt, government budget inflation and interest rates.

Before analyzing the data in detail, one must remember, that the Hungarian financial crisis in 2008-2009 had several causes, but at the root of the problems the financial vulnerability of the economy – caused by the spread of foreign currency loans – was to be found. The reason for that was that after the collapse of the Lehman Brothers and the disruption of international capital flows, the weakening Forint lead to higher installments of the private households which situation was compounded by growing unemployment. Growing unemployment, non-performing loans, problems to finance public debt – since interest rates were raised substantially – led to higher deficits in the public budget. Worsening rating of the Hungarian public and private debt triggered a new run on the weaker Hungarian currency. (It must be also added, that the crisis has other channels, such as the collapse of the international trade and the ensuing plunge of purchase orders to the Hungary-based international firms that form the backbone of the Hungarian economy.) Back then, breaking this vicious circle was not easy, and it is clear that the current monetary policy would like to avoid a similar scenario.

Therefore after 2008-2009, the Hungarian monetary policy focused very much on the reduction of stocks of foreign exchange loans. A few days ago, the

Central Bank of Hungary (MNB) published its latest data (August, 2018) on the aggregated balance sheet of credit institutions, these data help us to understand the efficiency of this policy, since the MNB was very successful in its efforts to minimize the share of foreign exchange loans, borrowed by private households. The stock of forint loans was 5.987 HUF billion in August 2018, while the share of foreign exchange loans was only a fraction of this sum – 38.5 HUF billion.

Generally, along with the rapid growth of the economy it is no surprise, that economic players – both non-bank firms and private households – extended their balance sheets siginificantly. Based on these data, the adjusted stock of real economy firms (non-banks) and private household loans and deposits grew in August 2018. It must be underlined that both the stock of forint loans and deposits increased while that foreign currency loans and deposits could decrease in private households. (In the table change of different segments of the loan and deposits stocks can be followed in August, 2018.)

Table 1
Changes in stocks of loans and deposits in August 2018 (private households and non-bank firms)

	Private households				Non-bank firms			
	Loans		Deposits		Loans		Deposits	
	Forint loans	Foreign exchange loans	Forint loans	Foreign exchange loans	Forint loans	Foreign exchange loans	Forint loans	Foreign exchange loans
	+52.9	-0.3	+42.1	-3.8	+74.0	+6.2	+0.1	-

Source: Central Bank of Hungary

Certainly, changes in loan and deposit stocks are the one side of the coin, developments in the public budget are equally crucial. In the first half year of 2018, revenues of the public budget rose by 9.5 percent compared to the same period in 2017. Among the different revenue items, production taxes grew most intensively – by 10 percent, while social contributions only rose by 5.8 percent and income tax revenues also showed a moderate growth (8.0 percent) It must be emphasized that the inflow of EU-transfers was a significant element in the aggregate growth, since these revenues at this item grew by 17.2 percent.

Despite these favorable trends, expenditures grew much faster than revenues in the first half year of 2018 compared to the same period in 2017. The growth of expenditures was 12.5 percent. Expenditures on functioning and accumulation transfers and public investments grew fastest during this period. (44.7 percent and 23.7 percent), while growth was below the average growth rate at the following items: employees-earnings (7.1 percent), expenditures on interest rates (-5.1 percent). As a result of these processes, in the first eight months, public budget balance deficit reached 120 percent of the sum projected and planned for the entire year! How important public financing issues are at the current state of the public budget, demonstrates the discussion in which the Hungarian Finance Minister, Mr. Varga participated this week. The minister said that cutting the income tax rate below 10 percent is not feasible for the time being since it would only lead to an additional deficit of 650 billion HUF.

In this situation it is good news, that the European Commission showed its willingness this week to pay out the remaining sums from the 2007-2013 financial period. Since years, the payment ratio of this period was at 94 percent, but after settling legal issues, the Hungarian government will receive around 420 billion HUF in the last months of 2018. Due to the inflowing EU transfers and the usual higher tax payments in December the public budget deficit will most likely go back to normal and this way former targets will be achieved. If they didn’t, the Government Debt Management Agency Ltd (Államadósság Kezelő Központ Zrt.) has a plan for the worst scenario, since it formed a buffer of 700 billion HUF, that can be utilized in this case, Mr. Barcza, the CEO of the Agency told the press this week.

It must be stressed that there are three macro-economic indicators that still recommend a cautious economy policy from the Hungarian government:

1. External balance. Foreign trade balance worsened in the first eight months of the year. The Hungarian export only rose by 0.9 percent in January-August 2018, while import surged by 6.1 percent. The increase in import volumes was very similar last year, however, the export could catch up with the growth. Thus, it is very likely that Hungarian trade surplus will be the lowest in 2018 in the last five years. According to analysts, the main reason behind this trend is to be found in the EU level discussions on car emissions standards, which could be settled this week and according to this sectoral analysis, the agreement will later speed up the Hungarian car exports in the remaining months of 2018 and improve the Hungarian trade balance significantly.

2. Inflation. The consumer price index rose by 3.6 percent in September, 2018 compared to September 2017. This figure is above the inflation target of the Central Bank of Hungary, and we can see a slowly rising inflation in 2018. If January 2018 were compared to January 2017, the same indictor would be 2.1 percent. Looking at the different main items, it can be observed, food prices, tobacco and liquor prices grew by 4.6 and 5.1 percent, while prices of services stagnated, because the price rise only reached 1.8 percent at these items. Obviously, weakening HUF explains a significant part of this rise in inflation, and looking the core inflation this assumption can be confirmed.

3. Exchange rate stability. Despite the heavy fluctuations in the international market, the Monetary Council did not change the interest rates conditions neither in September, nor in October. According to the protocol of September, the inflation in August (3.4 percent) was very close to the inflation target of the MNB, the inflationary pressures mainly came from the world economy, in particular as for gasoline, and not processed food, the inflationary pressure seemed to be significant. The Monetary Council also underlined that though the labor market contributed to growing inflationary pressures in the economy, but this effect was weak in its extent.

The inflation that can be observed in the Hungarian economy, is rather caused by external forces, and the economic potential is close to optimal, in other words the higher inflation is not caused by internal forces. The communication of the Monetary Council also referred to the importance of decreasing core inflation rates (around 2.5 percent), that also reflected the effects of eventual tax raises.

Based on former figures and analyzed trends in the briefing, we can conclude that though the external financing conditions of the Hungarian economy turned for the worse this year compared to past years, but the faster growing US economy and the rise in American interest rates are the real triggering factors in the transformation of the financial environment, not the deterioration of the Hungarian macro-economic indicators.

In our opinion, it is very likely that growing American interests will force international financial investors to rethink their strategies and re-balance their financial portfolio, which might influence the Hungarian financing conditions ultimately. However, it must be made clear, that in recent years the former very high exposure to external world changes could be reduced by the economic and monetary policy that is relying more on Hungarian savings than ever.