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# Hungary economy briefing:

# Public debt in Hungary

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# Public debt in Hungary

*This briefing look at the question of how Hungary has been managing public debt over recent years. After a short retrospect, focusing on mega trends, the paper investigates the basic data related to the development of public debt, the main trends and the achievements of the Hungarian economic policy after they year 2010. We will be able to see how the public debt level has decreased since 2011, and how the approaches in the management of the public debt have been implemented, respective that the Hungary has been able to set new goals (reduction of foreign ownership in public debt stock and the increase in debt share nominated in HUF.)*

## 1. Public debt: long-term characteristics

The period after the political and economic transition (1990-1995) was characterized by huge imbalances which for a short time were corrected by austerity measures in 1995 (the so-called Bokros-package). As a result of money-tightening policies, public debt jumped to 84 percent in terms of GDP. In the following period, from 1995 to the early 2000s, public debt could be pushed down to 51.5 percent, however, from these years on the growing indebtedness became more and more an negative but integral element of the Hungarian economic development, thus until the Financial Economic Crisis (2008-2009) this figure increased again to 71 percent. The crisis itself let jump public debt levels to 80.5 percent in 2011. We have to understand that the Financial Economic Crisis affected the Hungarian economy through various channels whose effects just strengthened each other creating a downward spiral in the economy: (1) the credit crunch and the freeze in the international trade had a huge impact on the backbone of the Hungarian economy, the manufacturing sector. Since the Hungarian manufacturing sector is deeply embedded in global supply chains, the effects of the credit crunch and the ensuing drop for manufactured goods felts its impact immediately. (2) Private debt – nominated in foreign currencies – led to bankruptcies and families losing their properties, since the other effect of the financial crisis was the drastically weakening currency; (3) Due to the uncertainty around the Hungarian economy and the mentioned devaluation, the Hungarian state bond interest rates skyrocketed forcing the Hungarian government to seek a rescue package from the European Union and the International Monetary Fund (thereafter IMF).

For the economy policy makers after 2010, it became clear that this crisis cannot repeat itself and they have to avoid the formation of the downward cycle, when the next crisis will strike the Hungarian economy. Thus, Hungary has put a lot of efforts in recent years to make the economy's financing more independent from foreign funding. After the peak in 2011, the public debt started declining in 2012, and it was around 67 percent in 2019. (The latest number is an estimate of the IMF.) We must add that the real public debt (net debt) is significantly lower, since the last figure was 60.4 percent in terms of GDP in 2019, but the same trends can be observed here as well: the peak in 2011 and since then a slow, but determinate decline.

## 2. Economic policy measures to restructure debt

The Hungarian Minister of Finance underlined in a radio interview a few days ago that the key pillars of the Hungarian economic policy have been the creation of new jobs and the reduction of public debt since 2010. As prove for the success of the Hungarian economic policy, he stressed that compared to 2010, 800 thousand more persons have jobs in Hungary and the public debt could be reduced from 83 percent in 2010 to 68 percent (end of 2019), though there is no final number for 2019 yet, he added.

In the same interview, he replied to two typical remarks/ criticisms of the Hungarian economic policy. The one strand of criticism states that the bulk of the Hungarian growth would come from receiving substantial EU-transfers. At this point, the Minister of Finance rightly pointed out if this statement were true, Central European economies would have grown at the same space, while the Polish economy increased by around 4 percent, Slovakia and the Czech Republic's economies grew by 2.0-2.5 percent, and the Hungarian economy expanded by around 5 percent last year. These substantial differences clearly indicate that growth not only comes from EU-transfers, it has more sources.

The second strand of criticism was that the state would increase public debt, or it would just deplete pubic wealth. The Minister of Finance argued that not only the public could be reduced substantially but public wealth could be increased by around 6093 billion HUF until the end of 2018. Recently published data also reveal that around 62 percent of this wealth is invested in real estate, properties, 21 percent in corporate stocks and the rest would be spent on goods, and movables.

The successful reduction of public debt is only the first element, the other crucial one is to increase the debt share owned by Hungarian firms and private households. In order to

achieve this goal, the Hungarian government launched its new state bond program in early 2019, that has been extremely successful since it promised over-average yields to the owners. The Ministry of Finances published several figures related to this program last week:

- In 2019 three times more people purchased state bonds than in 2013.
- The figure corresponds to the number of account holders at the Hungarian State Treasury. In 2013, 130 thousand accounts were at the Hungarian State Treasury, while 450 thousand in 2019.
- The stock of state bonds held by Hungarian citizens quadrupled: in 2013 the stock of state bonds was 500 billion HUF, while the same figure was 2.000 billion HUF in 2019.
- The attractiveness of the program comes from the fact the state bonds can yield 27 percent over the course of five years.

| Table 1.<br>Debt structure (in percent) | |
|---|---|
| Forint bond | 45 |
| Forint treasury bill | 2 |
| Forint state bonds for residents | 31 |
| Forint credits | 4 |
| State bonds in foreign currencies | 15 |
| Credits in foreign currencies | 3 |
| Sources: Government Debt Management Agency | |

As a result of the successful state bond program and other measures, the share of public debt nominated in foreign currencies shrank significantly from 52 percent in 2011 to 17 percent in 2019. The decrease of foreign share in debt has always been high on the agenda of the economic policy measures aimed at creating financial stability and the process will continue as the plans of the government indicated. Just three weeks ago the Hungarian government announced a program in which the Hungarian state repurchases Hungarian state bonds nominated in USD. The Minister of Finances underlined not only the interest charges of the Hungarian state and the foreign currency share of public debt will decrease but the financial stability of the country will improve. He added there is no need for the issuance of new bonds

to finance the repurchase program. In other words, this only move reduced Hungarian public debt by 800 million USD!

How important the reduction of the foreign currency debt share can be, the significant devaluation of the Hungarian currency showed this week. Despite the devaluation the Hungarian debt's financing is not in threatened since as it had been during the Global Financial Crisis, the high domestic ownership ratio in public debt doesn't force the Hungarian economy policy makers to take extra step to ensure the country's debt financing. At the same time, we can raise the question too what reasons for the weakening can be identified. Since the strong economic foundations don't explain the currency's devaluation (fast GDP growth, moderate inflation, surpluses on the current account balance and trade balance), we have to look for other answers. At this point, the low real interest rate level – the lowest one among the emerging markets, in particular in the Central European region – could be pointed out as an element significantly contributing to the weakening of the Hungarian currency.

## 3. Summary

As we could see the management of public debt has been successful in Hungary in recent years. On the one hand, foreign share in debt ownership and that share of foreign currency debt could be drastically reduced. During the Global Financial Crisis much of the problems originated from over-reliance on external funding, and the same asymmetric dependency led to problems in manufacturing and trade. Apparently, the Hungarian foreign policy makers are not willing to make the mistakes of their predecessors before 2008.

However, getting indebted in the right way is just one side of the coin, the other side is not getting indebted at all, thus tax reforms matter, and the reforms of recent years to improve the efficiency of tax collection, thus reducing shadow economy, greatly improved the public budget's situation and further reforms (sound budget) will help to reduce public debt in the long term. According to governmental estimates, the implemented reforms have already brought result and they reduced tax evasion in Hungary to around 9 percent which is a relatively good figure.