2018 elections in Hungary: political stability – curse or blessing?

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The FIDESZ-Christian Democratic coalition under prime minister Victor Orbán won the general election. They gathered 133 of the 199 seats, an expected 2/3 majority for the governing parties.

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The participation was 70% which is high in Hungary, especially if we note that 4 years ago it was only 62%. The new national-conservative government will be formed by huge majority and high legitimity. The election success of Orbán triggers critical comments in Europe. How will the political situation in the EU continue with a strengthened PM Orbán? The cabinet is expected to continue the economic consolidation and to fight political opponents using anti-migration topics. This strategy has been working for 8 years. Our view is that Viktor Orbán will not change the winning strategy. Harsh political communication and decisions against illegal migration (and NGO-s) are to be expected, paralelly also a slow but gradual economic convergence to developed countries. A goal that can be reached faster, if the new government is able to focus on economic competitiveness and fight corruption.

Expectations on bond and currency markets

Our view is that monetary policy remains dovish, the short end of the Hungarian forint bond yield curve will be anchored by the national bank. The long end stays dependent on the international yield trends. The debt management agency will continue to decrease the fx exposure of the public debt, we do not expect net REPHUN issues, so Hungarian hard currency spreads will remain stable. EURHUF volatility is very low, we do not expect extraordinary currency moves until national bank keeps its credibility.

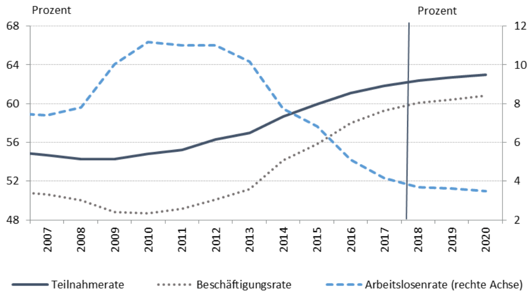
The development so far

The FIDESZ-Christian Democrat coalition has been governing Hungary for eight years. These are the most important achievements and failures of the FIDESZ era to date:

- The most important economic task of the government was to expand the fiscal wiggle room without breaching EU standards and to provide households with fiscal stimulus. Due to the depreciation of the Hungarian forint, a significant share of households were close to default as the FX-denominated mortgage loan repayments skyrocketed. This led to historically low consumer and business confidence. The Orbán government chose unorthodox measures to raise money in the budget.
- On the one hand, the government taxed the financial institutions, big retailers, and multinational companies and increased VAT from 25% to 27%, on the other hand they created the legal framework for private pension members to re-join the state owned pension system without their having to realise or carry over the losses they had run up on their investments.

A vast majority of employees opted for this approach, and HUF 3,000bn worth of investments were transferred to the state-run pension system. Government bonds were eliminated immediately, as a result of which public debt decreased by 5%. The new taxes allowed the government to cut work-related taxes and give extra support to working families.

Labour market:

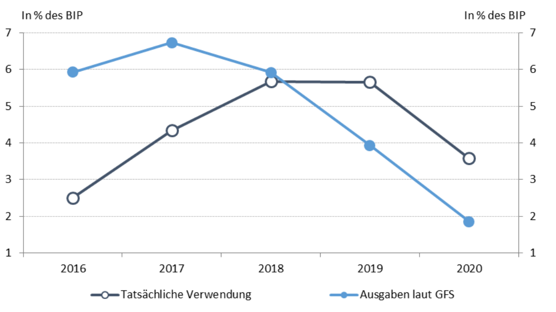


Use of EU structural funds

The allocation of the EU structural funds is a very important part of the governing structure. János Lázár, as the most powerful among the ministers, managed to set up a system to use as much money as possible in the quickest way, and align the spending process closely with the election year. This whole system could not work without very conservative budgeting, which materialised since 2011, causing the budget deficit to not reach the 3% upper limit. The first crucial achievement of this government dates back to 2013, when the EU stopped the excessive deficit procedures against Hungary. The rating agencies acknowledged this progress in 2016 and restored Hungary to investment grade category.

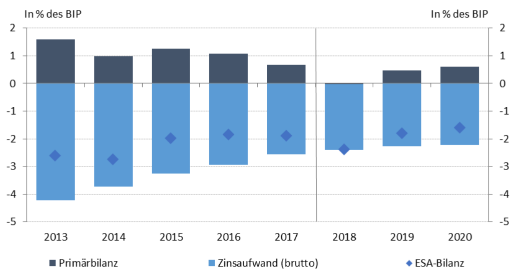
A debt management agency set strategic changes and targets. The first task was to pay back the EU-IMF loan that resulted from issues denominated in HUF. Two strategic partners appeared on the market that helped with this project: the first one was, broadly speaking, the household segment, which started to invest more and more money in popular forint securities issued by the state; the second player was the Franklin Templeton fund that bought about 10% of the public debt of Hungary between 2011 and 2014.

Utilisation of EU funds:



The ruling party appointed new MPC members to the Hungarian central bank, and a new governor was elected in March 2013. The new governing council managed to put the international trends to good use and cut the base rate from 7% to 0.90%. The inflation target was undershot, and monetary conditions helped public debt financing yields to reach new all-time lows. The credibility of the institution stabilised, but indirect political decisions are frequently detrimental.

Fiscal ballance:



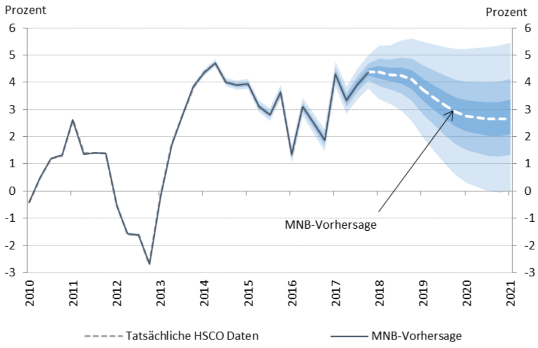
Swapping FX mortgage loans

The Orbán government produced one of its most important achievements in a concerted way. The Justice Department, the Economic Ministry, and the central bank found a solution that was acceptable for market participants and the EU to swap FX mortgage loans for forint loans. This solution helped both creditors and households, as NPL rates decreased and loan repayments stabilised on a lower level.

This economic stabilisation and the international economic trends have led to economic growth of 3-4% in recent years, all-time low unemployment rates, and increase in consumption, industrial production, and investments, a high current account surplus, and at the same time lower public debt, more stable public finances, and less FX exposure of households and the state. All this at 9% corporate tax and 15% flat income tax.

The biggest price of this process was the deteriorating competitiveness as the government used ad hoc, sometimes anti-market measures to reach political targets. Education and healthcare has been poorly organised and underfinanced. The effectiveness and fairness of EU fund allocation are questionable, and it distorts market and competition. The political stability has led to a system that is very centralised and comes with specific limits that depend on individuals embedded in politics rather than on institutions or principles.

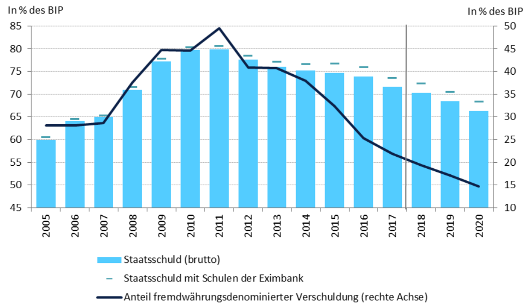
GDP growth and projection by the Hungarian National Bank



Changing the political framework

In parallel with the economic programme, the most important political targets were set too: a new constitution, a new election law, and a smaller parliament to regain public confidence in political institutions. Although this programme had been legally passed by Eastern 2012, public confidence has not been won back to this day, as none of these important decisions have been backed by any referendum.

Public debt:



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