Viktor Orbán's re-election and its impact on Hungary's fragile financial situation

Whatever the judgmental perspective on the drift towards illiberal democracy in Hungary, the question after Viktor Orban's resounding victory in the April 8th general election is whether this consolidation of a populist and Eurosceptic government within the EU creates a significant deterioration in Hungary's country-risk. In a nutshell, the answer is Yes, as pre-existing vulnerabilities makes the likelihood of liquidity and currency pressures much higher.

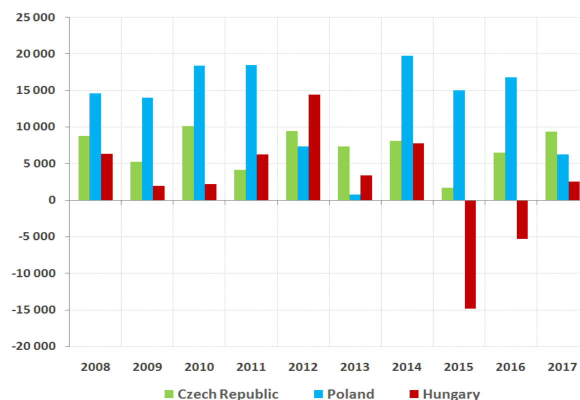
Victor Orbán and his political party Fidesz registered a clear and undisputed electoral victory two weeks ago, with general elections attracting a record turnout of almost 70% and nearly 50% of the votes supporting the incumbent Prime Minister. This will, in all likelihood, be an encouragement to continue its policy path, now termed as "illiberal democratic moves", including stricter controls on the judiciary and restrictions on media, coupled with nationalistic rhetoric and a strong negative bias towards the European Union (EU). The latter is shown not only through Hungarian opposition to EU policies, but also with a diplomacy creating proximity with Putin's Russia and China's Belt & Road Initiative (BRI).

Likely decline in stable capital inflows

The very first consequence of the election and projected policies is that tensions with the EU / EC will increase. The consequences are difficult to assess or forecast with any precision, but the fact that Hungary is a major recipient of EU financial support, notably through the European Structural Fund (ESF), clearly raise a higher-risk flag. Hungary's ESF allocation for 2014-2020 is EUR 27.9bn, i.e. a yearly average close to EUR 4bn: this is 6.9% of Hungary's total fiscal income in 2017 and 14.4% of its foreign currency reserves.

Another impact will be on foreign direct investment (FDI). For Hungary as well as for the other Central and Eastern and Central European (CEE) countries, FDI has played a critical role, not only in bringing needed foreign currency resources but in catching-up in industrial efficiency, technology. The picture for FDI into Hungary is blurred by specific corporate operations in 2015 and 2016, but a candid comparison with Poland (where look-alike policies and tensions with the EU exist) and the Czech Republic (much less similarities) suggests a growing defiance from foreign investors.

Foreign Direct Investment Inflows (mn $)



Sources: Central Banks, TAC ECONOMICS

High financial and liquidity vulnerability

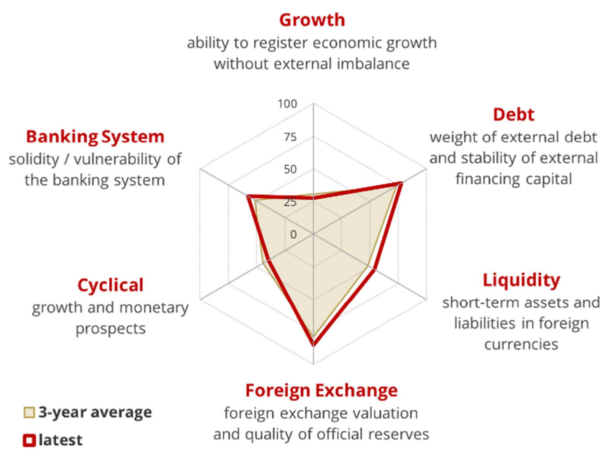
Our traditional polygon of performances on six Fundamental Balances is quite peculiar for Hungary, with very poor performances, simultaneously, on the Debt, Liquidity and Foreign Exchange Balances: though a part of such negative performance can be attributed to large short-term debt incurred between EU mother companies (including banks) and their Hungarian subsidiaries, the combination is a clear and undisputable sign of financial vulnerability, as expressed by the country average Economic & Financial Risk Rating at 62-D.

Investors may be deluded for a short period of time as both Growth and Cyclical Balances still show very positive performances (GDP growth expected at

3.8% in 2018). However, increasing worldwide financial volatility and the risks of subsequent increase in risk aversion will combine with Hungary's financial vulnerabilities and confrontational politics. Taking into account the Hungarian Forint (HUF) *unsustainable overvaluation* position in our Foreign Exchange Balance, such politically-induced liquidity pressures would create immediate depreciating forces.

Hungary – Scores on Fundamental Balances

From 0 (lowest risk) to 100 (highest risk)



Source: TAC ECONOMICS

The HUF competitive overvaluation (around 20% today, with a EUR/HUF value at 312 on April 24th) may last for a while, but will have in any case to be adjusted over a medium-term horizon of 2-3 years; a sudden increase in political tensions with the EU would accelerate the process and make it more difficult for Hungary to manage. This is now a core risk for foreign investors, coupled with the (undefined) consequences of nationalistic policies vis-à-vis foreign investors, notably in periods of political tensions.