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IMF, European Union and World Bank support credit crisis relief measures

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Background

Hungarian banks have long been complying with regulatory capital requirements and have been operating profitably. They pursue more conservative lending policies than banks in some other countries; sub-prime lending does not exist; and they have not invested in collateralized debt obligations or similar assets whose market liquidity and value have virtually disappeared. In addition, 80% of Hungary's banks are foreign owned - most are subsidiaries of euro-era parent banks with access to the liquidity facilities offered by the European Central Bank (ECB). The Hungarian authorities and representatives of the banking industry frequently stated that Hungary would not be directly affected by the international credit crisis; however, it was among the first of the emerging-market countries to suffer. The decline in global liquidity and an increase in risk aversion magnified the country's underlying weaknesses - in particular, the high levels of external debt and fiscal deficit, together with a relatively large public sector and reduced investor appetite for Hungarian assets.

International Assistance

On October 13 2008 Dominique Strauss-Kahn, the managing director of the International Monetary Fund (IMF), stated that:

> "*Against the background of global financial turbulence, Hungary's government securities market and some other key markets have experienced stress over recent days... I have informed the authorities that the IMF stands ready to assist their efforts.*"

On October 16 the ECB established a €5 billion borrowing facility for the Hungarian National Bank to support the latter's newly introduced euro liquidity operations. This was the first instance of the ECB providing financing to the central bank of a country outside the eurozone.

On October 28 the IMF, the European Union and the World Bank announced a joint financing package for Hungary totalling $25.1 billion (€20 billion) which comprises:

- an IMF standby arrangement of $15.7 billion for a period of 17 months, which entails exceptionally high-level access to IMF resources, amounting to 1015% of Hungary's IMF quota;
- financial assistance from the European Union in the form of a medium-term loan up to $8.4 billion on the basis of EU Regulation 332/2002, whereby the European Union can grant mutual assistance to a member state outside the euro zone if it is in difficulties or seriously threatened with difficulties as regards its balance of payments as a result of an overall imbalance in its balance of payments or the type of currency at its disposal; and
- $1.3 billion from the World Bank to tackle long-term structural problems and reform key areas, such as the financial sector, the fiscal management sector and the social sector.

The joint facility is intended to provide Hungary with sufficient reserves to meet its external obligations, even in extreme market circumstances, thus easing financial market stress in Hungary. The package (i) supports government measures on public finances and the banking sector, and (ii) aims to improve investor confidence and prevent the crisis from spreading further in the region.

In the fiscal sector, the primary objective is to ease the country's short-term financing pressures and bring down the high levels of debt. The 2009 Budget has already been submitted to Parliament, then withdrawn and resubmitted; now it will be amended again to reflect the deterioration in the economic outlook and to implement further reductions in the government's borrowing requirement. In order to maintain long-term fiscal discipline, a rules-based fiscal framework will also be introduced. The government has proposed legislation that would establish rules on public debt and primary deficit, as well as creating multi-annual expenditure ceilings and a fiscal council to provide independent expert scrutiny.

Guarantee on Deposits

The government has submitted a bill to increase the level of deposit insurance coverage for retail deposits from Ft6 million to Ft13 million (in line with EU agreements). In addition, the government has pledged to provide a blanket guarantee on all deposits.

Bank Support Package

The government will provide a Ft600 billion support package to systemically important domestic banks with a regulatory capital of at least Ft200 billion. The funding is divided equally between a capital base enhancement fund and a refinancing guarantee fund. Amounts not invested before February 28 2009 will be added to the guarantee fund.

The capital base enhancement fund provides pre-emptive recapitalization and has been sized to bring the eligible banks' capital adequacy ratio up to 14%. The state will obtain non-voting preference shares against the capital injection. The bill provides for two exit routes: the institutions will have redemption rights if their capital and liquidity position is strong enough and the state will have the right to convert its shares into ordinary shares for sale on the market.

The guarantee fund aims to secure the refinancing of the eligible banks and to strengthen the banks' position in an international market where their competitors already have access to similar guarantees. Open to new transactions until the end of 2009, it will guarantee the rollover of loans and wholesale debt securities with an initial maturity of between three months and five years. This package should ensure that Hungary's banks remain capable of playing a responsible role in respect of their foreign subsidiaries in neighbouring countries.

Regulation and Supervision

The new measures will strengthen financial sector regulation. Measures include:

- the introduction of a positive credit registry for households;
- the modification of the Central Bank Act to allow the Hungarian National Bank to request individual but personally untraceable data to ensure an adequate analysis of credit risk;
- enhanced regulation of insurance brokers, credit brokers and their products;
- the introduction of maximum loan-to-value ratio requirements for new mortgage loans; and
- close monitoring of banks' foreign exchange exposures.

The government will submit a bill to (i) strengthen the capacity of the Financial Supervisory Authority and the Hungarian National Bank to assess and address solvency and liquidity concerns in banks in a timely manner, and (ii) entrust the authority to take early remedial actions and exercise emergency powers.

Consumer Relief

A substantial proportion of Hungary's total pool of residential mortgage debts and consumer loans is in foreign currency (mainly euros and Swiss francs) because of a significant difference in the interest rate of forint and foreign currency loans. This exposes borrowers to exchange rate risk, which has increased significantly as a result of the crisis. The government has reached an agreement with nine main commercial banks (with other banks expected to follow) to mitigate the balance-sheet risks of households from their exposure to foreign currency loans and to establish a private debt resolution strategy. The agreement provides that:

- the banks will allow the duration of a loan to be extended (with fixed monthly instalments) at the debtor's request;
- debtors will be allowed to convert their foreign currency-based loan into a forint loan at no charge;
- if a debtor is unable to service the existing loan, the banks will be amenable to a transitional reduction in instalments; and
- the banks will ease existing conditions on prepayment of loans.

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