Communicating downgrading

For a few days Moody's rating downgrading provided ammunition to everyone in the intensifying communication warfare. But while both sides of the political aisle engaged in mutual recriminations regarding the other side's hypocrisy, a discussion of the underlying issues – whether the downgrading made sense and what impact it might have – fell by the wayside.

This week both the opposition and the government press were glad to discover that the government and the opposition parties are, respectively, hypocritical. Last Monday Moody's Investors Service downgraded Hungary's government bonds by two levels, from Baa1 to Baa3 rating, just above junk status.

Following this move, Hungary's creditworthiness is among the most damaged in the European Union and Hungarian bonds are tied with Romanian, Bulgarian and Latvian bonds as the riskiest among the new member states. Given that Standard & Poor's already has Hungary just above junk status and Fitch is only a notch more generous for the time being, the credit rating agencies' warning signal is clear.

Minister for the National Economy György Matolcsy, who is also in charge of the treasury, took the news with equanimity, arguing that the government had anticipated this judgment, which is indeed likely. In an interview with the BBC, Foreign Minister János Martonyi was less nonchalant and called Moody's decision a 'huge mistake' given that the Hungarian fiscal policy is presumably on solid footing for years to come. Martonyi urged Moody's to reconsider.

During a state visit to Lithuania, Prime Minister Orbán echoed Matolcsy, noting that both the budget deficit and state debt were set to decrease next year. He also said that Moody's move would not necessitate recalling the IMF to help Hungary, which the government had sent packing following rather tense consultations a couple of months ago. The government, for one, remains confident that international investors will continue to fund the Hungarian deficit.

The largest opposition party, MSZP, harshly attacked the government on account of Moody's rating decision. In Parliament, MP Gábor Simon asked in light of the downgrading 'how much further [the government] would devastate Hungary's market positions'. MSZP's senior financial policy expert, Tamás Katona, called the decision a 'slap in the face' for the government and noted that after a wide variety of experts had already expressed their misgivings about the government's fiscal policy, now they had been joined by Europe's most influential credit rating institution.

Though the market's reaction was negative, in the end the downturn in the forint's value and the stock market was not dramatic, also supporting the government's view that Moody's decision was not a major surprise.

Hypocrisy everywhere

Given that the Gyurcsány Cabinet had experienced plenty of downgradings on account of both, its reckless fiscal policy before its re-election in 2006, as well as the effects of the global economic and financial crisis, it was logical that there would be prior statements to prove that the current ruling party, Fidesz, and its predecessor as the main government party, MSZP, had previously taken a view of the credit ratings that was not consistent with whatever they had to say now.

When Fitch downgraded Hungary in 2005 – at this point the international environment was considerably better than in the period since 2008 – the Socialist Finance Minister Tibor Draskovics reacted similarly to György Matolcsy's recent comments, saying that 'naturally I am not pleased with the downgrading, but it will have no effect on financial policy, since the [reasoning] contains nothing new'. Later downgradings elicited similar responses.

Fidesz, on the other hand, was less understanding with the government than it is now, and with regard to a downgrading by Rating & Investment Information service in 2008 a party spokesman wrote: 'This most recent instance of [Hungary's] downgrading is evidence that the minority government is incapable of handling the crisis'.

Naturally, the press pounced on statements such as the ones above and the discussion of how the opposition and the government perspectives had become interchangeable came to dominate much of the political discussion, thus also clouding the more serious question as to whether Moody's decision was well-grounded and what its implications are.

Partly, the controversy became a Fidesz-MSZP private affair on account of the fact that the other two opposition parties, Jobbik and LMP, chose not to engage in the debate, presumably not wishing to be identified with the criticism of a foreign organization but not wishing to express their support for the government either.

Moody's decision

Government politicians' main complaint about Moody's decision was that it had failed to take into account that within a European Union otherwise awash with huge deficits, the Hungarian budget will likely rank among the most consolidated next year and, along with Sweden, Hungary will probably be the only EU country next year that could reduce its national debt.

Fair enough. And if Moody's had issued its verdict merely based on and regarding next year's expected budget balance, then it would have likely missed the mark. But Moody's referred explicitly to medium- to long-term fiscal sustainability. It argued that the stopgap measures imposed now will not have a lasting effect. '[T]he government's strategy largely relies on temporary measures rather than sustainable fiscal consolidation policies,' argued Moody's VP Dietmar Hornung in justifying the agency's decision.

What economic analysts in and outside Hungary have often lamented is the lack of structural reforms and budget cuts that would give the budget greater long-term stability than temporary punitive taxes and the one-off nationalisation of private funds. Moody's is similarly troubled by the lack of reforms that could put public finances on a more solid long-term footing.

In part, therefore, the absence of deeper, cost-saving reforms is what drives professional financial market analyses of the Hungarian government's performance. There are those who assume that such reforms are planned but have not been released yet. This hope was fairly widespread before the elections and for a brief while in the subsequent period, too. Lately, the number of adherents is dropping and scepticism is increasingly openly voiced even among some right-wing economists.

Orbán himself has repeatedly stressed that the talk of austerity is unnecessary and counterproductive; Hungarians, he argues, have suffered more than enough from budget cuts and revenue-raising measures affecting the public. These often – and sometimes unsolicited – reiterated commitments suggest that he is, at least for now, serious about this course of action, which offers little support the optimism of those who continue to wait for tough love from the government.

Only at this year's speech in Kötcse did Orbán note that massive fiscal adjustments would be necessary and acknowledged that these would be painful. He also remarked that it would cost Fidesz some support and that the massive coalition of voters that it had put together might not last. In retrospect, it appears that he might have hinted at something like the nationalisation of mandatory private pension funds.

Whether that was the point he was making or not, the question also remains if there is something else that Fidesz has up its sleeve. In the short run, the Robin Hood taxes and especially the massive nationalisation ought to keep the budget in order, unless the government squanders its newly requisitioned wealth.

But in the long run, there are two hurdles ahead. The state is and remains both vast and wasteful and the lower tax rates will reduce revenues unless economic growth is very robust and the proportion of declared incomes increases, both major ifs. So as far as the long haul is concerned, Moody's appears to be right on the money, pun intended.