State debt: Public Enemy No. 1 is on the loose again

Debt was one of the major issues this week, with several online publications pointing out that despite the government's insistence that victories have been achieved on the debt-reduction front, the real numbers look disquieting. In major part due to the forint's deprecation, the budget's net total debt was at an all time high in September, official figures reveal. The government is countering that these figures do not mean much, for much of its revenue is raised towards the end of the year. That may well be the case, but government projections have been known to be excessively optimistic with regard to revenue expectations, and in light of the country's precarious international financing there isn't much room for error. Moreover, a glance at the trends projected for 2012 reveals that for all its uncertainties, the current annum will nevertheless be the easy year.

As the Prime Minister has repeatedly noted, national debt is "*the* enemy", and the government is determined to defeat it. Being *the* enemy of a government that appears to have so many enemies is indeed a pre-eminent position. It promises considerable attention and efforts for years.

Indeed, Fidesz has even tied the fate of a significant slice of the rule of law to overcoming this particular enemy: only if national debt drops below 50% of GDP will the Constitutional Court receive its full powers of judicial review back. The argument behind this odd measure is that for the time being the government must take drastic measures to reduce the vast mountain of deficit. Since some of these measures will presumably be unconstitutional – even according to Fidesz' own Basic Law – the Court, despite being stacked to the hilt with Fidesz appointees, ought not meddle.

Yet despite marshalling impressive resources from the nationalisation of over a decade's worth of (formerly private) pension funds, the fight does not appear to be going all too well. It's much to early to declare a winner, but we can at least review the first rounds of this epic struggle.

Early plans

Initially, the government's plan had been a significant reduction already in the spring, taking debt down from 82% to 73-74% of GDP. That would have been a significant achievement within a year of taking office. By comparison, the most successful debt-reducing government thus far, the MSZP-SZDSZ coalition between 1994-1998, shaved off 23% of the national debt in four years. Though it prides itself for its previous debt reduction, Fidesz itself managed under 10% during its 1998-2002 term. And the subsequent Socialist-led governments piled up massive debts again.

By the end of the term the PM wants debt to be between 65-70% of GDP, meaning much of what the government wants to achieve in this period would have been fulfilled this year already.

For the moment, however, hopes for early relief have been dashed. It took the government until June to use 4.5 billion euros from the private pensions funds (roughly half the entire fortune) to reduce the debt to 77% of GDP, above the envisioned target. In September, however, PM Orbán announced another round of debt reduction, 4 billion euros – 3 billion from foreign currency reserves and 1 billion from pension funds' stocks – which would realise the 73% target projected for the spring.

Lacking clarity

It is unclear where the debt stands now in relation to GDP. While in response to a series of critical articles last week the Ministry of National Economy (NGM) issued a statement that it is down to 74%, i.e. almost on target, an independent expert claims that it is in fact closer to 77%, 76.8%, to be exact.

The government is not helped by its own "debt meter" (a catchy online tool that caused a minor stir itself because of its hefty price tag), which says debt stands at 76.1% – much closer to the independent expert's assessment than to the economic ministry's statement.

Debt reduction fails the midterm

While there are various ways to measure debt (as a percentage of GDP, broken down by types of debt, adjusted for inflation, in nominal terms, etc.) one key measure caused a major uproar last week, going through several of the major online blogs and emerging as a headline even on Index.hu, Hungary's most influential online news portal.

After taking a dip at the time of the debt-reduction frenzy in June, the central budget's net debt was through the roof again in September, reaching a record high of 20,626 billion forints. Experts say this is mostly due to the deprecation of the Hungarian currency, as roughly half of Hungary's debts are denominated in foreign currency, exposing the total level to exchange rate fluctuations.

This is somewhat ironic in light of citizens struggling with their Swiss franc debts, but at the same time it is also neither unusual nor the current government's fault on the whole.

Not so fast

Reacting to the flurry of journalistic activity pouncing on the next bit of bad news concerning the government's fiscal and economic policies, the NGM issued a statement advising the public not to heed the critics. First of all, the statement argued, as a percentage of GDP debt is down to 74%. We discussed this above.

Second, the ministry says, the presentation of mid-year numbers is misleading because much of the tax tally will be due towards the end of the year, meaning that an assessment now biases the count against the government. By year's end all will be in order.

Critics counter, however, that before they laid out the situation in September, it had been the government that bragged about reducing the debt in June and September, thus setting the current status up for more scrutiny.

Cause for optimism?

Still, it is indeed true that year's end may well leave things looking much brighter, yet the frequent corrections of the NGM's projections also make a sceptical monitoring reasonable.

What the government failed to mention in its defence, of course, was that the dire straits the debt level is experiencing now is partly due to the forint's performance. While this would have been true, it hardly would have done much to improve the government's public case.

The forint's weakness is in no small measure itself a result of shaky fiscal policy and laggard growth, as well as measures that financial markets deservedly loath, such as the mortgage pre-payment plan that is effectively another punitive tax on banks.

For this reason, the government is naturally not keen to push the forint's weakness as an excuse.

Set for victory

The government is also in a trap typical of high-risk countries (and in fact even of mid-risk countries that do not wish to join the circle of the latter). Much of the reasonable discussion surrounding the debt level would start with admissions that there is something wrong with the way the deficit and the debt are playing out.

While a few weeks ago Orbán publicly conceded the problems in terms of growth – simultaneously also expressing some disappointment with Matolcsy, which was in itself an unusual admission – even if he wanted to, he does not have the luxury to display such openness about the debt. With Hungary recently entering the rank of the top ten countries at risk of a state default, the PM has to make sure that his communication does not betray any lack of confidence in the country's ability to stay on course with regard to the deficit and debt reduction (which has not stopped him or other Fidesz politicians from repeatedly dropping the ball on related issues and sending the forint plummeting with gaffes and reckless policy promises).

So where does all this leave us? For one, anxiously hoping that the government is right and the figures at the end of the year will end up confirming its deficit targets and debt-reducing course. In light of our precarious financing, anything less might prove disastrous. At the same time, we are not nearly as optimistic with regard to next year.

Looking at critical analyses of the budget's shortcomings and the ominous economic news from global markets, next year looks like a dark abyss. And if Hungary keeps underperforming the NGM's overly optimistic projections, then its references to end of the year numbers might not do much for us in the final analysis.