Lessons Learned: Ádám Balog

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From 2013 to 2016, Ádám Balog was deputy governor of the National Bank of Hungary (Magyar Nemzeti Bank, or MNB) and a member of the Monetary Council. During the Global Financial Crisis (GFC), Hungary was unable to finance its external debt and negotiated a three-party agreement with the International Monetary Fund (IMF) and the European Union. In this interview, Balog describes the conditions in Hungary before the crisis and the challenges and decisions that he worked on during its aftermath. This Lessons Learned summary is based on an interview with Balog held on February 1, 2022. The full transcript can be accessed here.

Governments of emerging economies need to be vigilant to ensure that external funding does not cloud their judgment and risk assessment, which can lead to bubbles and financial instability.

In 2007, Hungary was a rookie, not a veteran, at regulating a market economy within a globalized financial setting, Balog explained—“those who graduated after Hungary became a market economy were still under 40 when the GFC hit.”

Hungarian economic elites had reasons to expect the country might stay insulated from a rich-country financial crisis. Hungary was not overly banked or financialized. It was not a member of the Eurozone, though elites then thought it was on the path to joining. Until the GFC hit, the country had access to abundant cheap external financing, just from its new open status and recent memberships in NATO and the European Union (EU). According to Balog, a feeling of financial access was pervasive in Hungary during these years: “You waited for decades to join the club and, yes, now you are in. . . Politicians and bureaucrats in Hungary thought that our risk premium would decrease immediately, . . . [and that we would] receive a lot of EU funds.” But, Balog continued, this abundance of cheap funding “clouded our judgment before the GFC so that we did not focus enough on adjusting the imbalances of the Hungarian economy.”

Hungary’s vulnerability to the financial instability of rich countries was greater than its leaders understood. Amid this misunderstanding, Hungary’s leaders allowed risks to build. In 2007, as Balog described, “around 60% of the total state debt at the peak was financed from abroad, maybe even more. . . Huge government debts were denominated in hard currencies, a current account deficit, a budgetary deficit, and the whole household sector was sitting in a big Swiss franc loan position.”

After Lehman Brothers collapsed, “in a very short time, financing of the state became very difficult and expensive . . . [and then the] state debt market completely dried up.” The GFC experience made one lesson very clear to Hungary’s financial leaders, said Balog: “Whatever your political or economic ambitions are, you have to be able to maintain your liquidity” in terms of foreign exchange. For a small open-economy country such as Hungary, “cash is king.”
Assistance from the IMF or other intergovernmental organizations may be necessary, but it does not replace the government’s own responsibility and accountability for addressing a crisis.

In early 2009, said Balog, Hungary was still a relatively new open economy, and the nation found that its ability to issue debt suddenly evaporated as the effects of the GFC spread throughout Europe:

Our state bonds practically had no liquidity. The money simply did not come, and the liquidity disappeared from the state bond market. And then the risk premium increased, and we were downgraded by the rating agencies. And after that, obviously, financing of the state, of the other nongovernmental sectors, generally became extremely expensive. And this slowed down the whole economy.

The IMF and EU joined together to assist Hungary. However, Balog cautions that any country undertaking a program like this should be prepared for the conditionality demanded by such organizations and should approach the situation with a conservative perspective.

He believes that the design and application of IMF relief should emphasize its interim nature. For relief to work, Balog stressed, it is up to the country’s leaders to make the right decisions and actions, because only they can:

I think what any economy in such a situation has to understand, but also what these big intragovernmental organizations need to understand, is that such help, by its nature, can be only interim. And it can only have an average result. I think only a sovereign country, its leadership, can make really good decisions in such a situation. Surely, being honest, they can make the really bad ones as well. But, help, such as the IMF and EU help, can only be average. And the state has to accept that. It’s not a goal to provide you with the luxury lifeboat and bring you to a beautiful island until everything is over. It’s just enough to keep your head above the water. But then you have to do it. It’s your responsibility. It’s your country.

The physical presence and hands-on direction of the IMF should be limited in time, advises Balog. Running for two or three years is not sustainable. Balog describes how IMF overseers insisted on austerity measures and ruled out suggested revenue innovations that later proved effective. He would advise a less direct approach:

Obviously, they have the requirements agreed upon in an agreement, until the loan is there, because it’s their money, for example, the money of the international community. But they should consider setting the scene and saying what other borderlines apply, laying out parameters, but then leaving the country to work out itself how it would best manage the situation. I think probably this would work better in most of the situations.

A central bank that is not independent from the government and the financial sector will not be effective in forestalling or fighting a crisis.
Since the beginning of the 2000s, Balog emphasized, the MNB has developed greater independence from the state and from the financial industry. However, as a young central bank, during Balog’s tenure, the MNB found itself in awkward situations, arguing for actions that were received very controversially. One situation he described related to when to lower rates post-GFC while maintaining financial stability in the system:

So, to put it simply, there was the financial stability approach and the real economy approach. These two were fighting, and both stated good reasons. But after a while we have seen there are fewer and fewer concerns about financial stability in the short term and more and more concerns about the reviving of the economy. And then the decision was made through votes in the Monetary Council that interest rates have to be cut. There were some who disagreed, they voted differently. Then fewer and fewer Monetary Council members voted differently. And after a while, but many years later, the voting became quite unanimous, as with regards to the interest rates.

Today’s MNB, said Balog, makes decisions not to help the state but to promote price stability and growth. He pointed to the country’s price stability record for the decade beginning in 2007 and the decision-making process on the Monetary Council. Based on his experience on the Monetary Council from 2013 to 2016, Balog emphasized that interest rate decisions were made on the basis of independent analysis, listening to different sides of the debate without dependence on the government.

He concluded that a central bank’s independence is critical to its credibility.

National banks really have to be independent, but not just from the government. The central bank has to be independent from the financial sector as well. It has to be independent from intergovernmental organizations. They really have to be able to use their specialized knowledge to make the best decisions it has to make at a given time. This can include also financing the state, as practically happened in big central banks in the past few years. But it only works if it’s the decision of the central bank. The question is: Who made the decision? And it’s very important that the central bank gets to make the decision. And it can’t ever operate from [the] other way around. OK, this decision has been made. This is good for the government. Then it’s not an independent decision. It’s another way around.

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