Lessons Learned: Júlia Király

Matthew A. Lieber

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Júlia Király was deputy governor of the National Bank of Hungary (Magyar Nemzeti Bank, or MNB) from 2007 to 2013. A financial economist serving on MNB’s advisory board in the 1990s, Király helped formulate and adapt Western banking frameworks for Hungary’s economic transition away from socialism. As deputy governor, she oversaw Hungary’s emergency response to the Global Financial Crisis (GFC). A professor of finance at the International Business School Budapest, Király is the author of Hungary and Other Emerging EU Countries in the Financial Storm, published in 2020. This Lessons Learned is based on an interview with Király on June 7, 2022. The full transcript can be accessed here.

The central bank should have the leading role as the macroprudential regulator and supervisor for the banking system, so it can manage systemic risks and financial stability.

For Király, the fact that the central bank should lead the way was an important lesson that Hungary learned from the crisis. Compared to other small independent-currency countries like Ireland and Iceland, in 2008, Hungary had a much less developed and smaller financial industry, which, according to Király, should have made it less vulnerable to the GFC.

However, before the crisis, Hungary’s Ministry of Finance was responsible for regulations relating to the banking system, and prudential supervision over banks was the responsibility of another agency, the Financial Supervisory Authority. One problem with this segmentation of authorities, according to Király, was that the central bank could not change practices that it thought were contributing to instability, such as mortgages denominated in Swiss francs rather than local forint. From 2002, foreign currency lending rose dramatically; specifically, Swiss franc–denominated household debt would become the most damaging exposure across the nation.

Király and others at the MNB saw the vulnerability but did not have the regulatory authority to step in. Several weeks after the collapse of Lehman Brothers, “almost all the Hungarian financial markets stopped.” Like many similar countries, said Király, Hungary was facing a tremendous liquidity crisis, but one much worse than that of its peers.

On the 9th of October, the FX swap market collapsed, which was the funding market for the banks, and the government bond market stopped. The Treasury could not issue new papers. And of course, the stock exchange collapsed as well, where one of the major listings is the biggest Hungarian bank’s stock, the OTP, and the OTP collapsed.

It was a liquidity shock, which really attacked not only the government paper market, not only the government bond market, but the banking market as well. In the first
day, we had to provide liquidity for the banks, and what was difficult [was that we did not have to provide liquidity] in Hungarian forint, but in FX.

That is the big difference between Hungary, Romania, Serbia, and other countries, that the liquidity crisis was not in local currency. [With] local currency, we had no problem on [any] of the markets. We had [a] liquidity problem in foreign currency. That’s why we say the famous Eichengreen type of “original sin” [borrowing in a foreign currency and accumulating a currency mismatch] was committed by us. That is why we applied to the [European Central Bank (ECB)] for a swap line, for a euro-forint swap line.

The ECB originally turned down the MNB’s request for a swap line but later granted it a repo line (accepting euro-denominated securities instead of forints for euros). The country was also able to negotiate assistance from the International Monetary Fund (IMF) and European Commission, which helped it through a recession.

According to Király, Hungary was a “quite healthy” economy at the time, and its issues “were mainly liquidity problems and not solvency problems.” But, she continued, “liquidity problems in FX are significantly different from liquidity crisis in local currency. And that’s why sometimes it looks like a solvency problem.” Despite this, no Hungarian banks went bankrupt during the crisis, and in 2011 Hungary reformed its system of banking regulation to integrate macroprudential regulation and supervision of banks into the central bank’s authority.

**Given the interconnectedness of financial systems and markets, no country can solve a global financial crisis by itself: Cooperation, coordination, and creative thinking are required.**

The response that ultimately resolved Hungary’s liquidity crisis of 2008 was a rescue package to which the IMF and the European Union agreed. However, by early 2009, a new round of financial diplomacy was required, and not just for Hungary. As Király put it,

> At the beginning of 2009, it was the crisis of Central and Eastern Europe, not only of Hungary. It was the time when Western countries, especially Eurozone countries, turned inward, and the governments of the Western countries [forbade] their banks to help their Eastern subsidiaries.

The situation was resolved by what came to be called the Vienna Initiative. The initiative was a framework among public and private parties, governments, commercial banks, central banks, and international institutions that “sat around the table” to resolve what was by then a second liquidity and FX crisis for most of Central and Eastern Europe.

According to Király, some of the parent banks in the Western countries did not want to let their subsidiaries go through a liquidity crisis or go bankrupt. These interests were key in achieving the cooperation of the Group of 20 (G-20) countries. After much debate, they finally said they would cooperate and show solidarity toward countries in crisis, and they
recognized “that it’s in the interest of all the countries not to let the vulnerable countries be underwater,” said Király.

Specifically, the Vienna Initiative included a commitment by the large Western banks not to pull capital from their subsidiaries in countries where the IMF provided support. Király credited the G-20 and ECB President Christine Lagarde for the enlightened turn in international financial crisis response. And Király views the ECB’s quick provision of euro liquidity to non-euro members of the European Union in March 2020, as the COVID-19 pandemic hit, as a legacy of this new cooperative thinking.

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