YPFS Lessons Learned Oral History Project: An Interview with Júlia Király

Júlia Király

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Introduction

The Yale Program on Financial Stability (YPFS) interviewed Julia Király about her time as deputy governor of the National Bank of Hungary (Magyar Nemzeti Bank, or MNB) and, more specifically, her involvement in Hungary’s response to the Global Financial Crisis (GFC). Király began her career as a financial economist during the final decade of Hungary’s socialist era, in the Central Statistics and National Planning offices. As a financial consultant and advisory board member of the MNB, she helped formulate and adapt western banking and financial economics frameworks for Hungary’s economic transition. Called to service in 2007 as Deputy Governor, Király oversaw Hungary’s emergency response to the foreign exchange and state funding crises spurred by the GFC. In her 2020 book *Hungary and Other Emerging EU Countries in the Financial Storm*, Király takes readers inside the negotiations behind the Vienna Initiative giving the perspective of a central bank firefighter of a small open economy with an independent currency.

*This transcript of an interview has been edited for accuracy and clarity.*

Transcript:

YPFS: **Professor Julia Király, you have had an amazing career. How did experience in the statistical office in the 1980s and as an advisor on the board of the National Bank of Hungary prepare you for your role as Deputy Governor in 2007?**

Király: I graduated in Hungary in the beginning of the ’80s, during the socialist direct planning era. I joined for the Statistical Office and then the Central Planning Office as a model builder, mainly in input/output, and then econometric

1 The opinions expressed during this interview are those of Ms. Király, and not those any of the institutions with which she is or has been affiliated.

2 A stylized summary of the key observations and insights gleaned from this interview with Ms. Király is available [here](https://link.springer.com/book/10.1007/978-3-030-49544-2) in the Yale Program on Financial Stability’s *Journal of Financial Crises*.

models we used for the background of the five-year and one-year plans. It lasted until the 1990 when Hungary and the neighboring socialist countries transformed from planned economies to market economies. In 1990, I joined the newly founded International Banking Institute of Training and Consulting. We started to build the two-tier banking system, to train and consult regarding the two-tier banking system.

It was quite the new experience in Hungary, where you had the central bank during the planned economy. In the 1990s until the middle of the 2000s, the bank really built a new science—banking, risk management—in a country where this terminology was absolutely unused.

As such, I worked very often for the central bank when György Surányi was the Governor of the central bank. I was on his Advisory Board; I was on the Advisory Board of the Supervisory Authority as well. I worked on the macro questions and micro questions as well, but I was mainly involved in the banking issues, in bank risk management and case studies.

I lectured at the University of Budapest Economics. We introduced the lectures on value at risk at the end of the ’90s. We learned during the ’90s and 2000s what a liquidity crisis can mean for a bank. It was very interesting to face these problems when I became the deputy governor of the central bank in 2007 responsible for financial stability. I kept saying, “I joined the central bank in July 2007 as deputy governor responsible for financial stability, the day when the supreme crisis actually started.” It was our first experience.

YPFS: That’s ironic and challenging. You came into the central bank in 2007. Hungary’s experience of the Global Financial Crisis, when was that really felt?

Király: When I entered the central bank, we already knew that something very special had started. During the summer of 2007, most of the people expected that there would be a soft landing, number one. Number two, most of the experts expected that this time it was a crisis of the advanced financial markets. I do remember the Governor of Mexico’s central bank said, “This time, it’s not us.” It means that this time, the developing countries were not involved. There was a well-founded theory of decoupling. We were convinced that, “OK, there will be some influence of this financial crisis on the developing emerging markets, but it will not be so terrible as the earlier crisis.”

I had a famous paper4 with my deputy Márton Nagy about the first phase of the crisis (he is actually now Minister of Economic Development in

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Hungary[2022]). The paper was published at the beginning of 2008. It analyzed the subprime crisis and the possible channels of contagion. Our conclusion was that "Hungary is in a difficult position, but in Hungary, the imbalances have been improving. Maybe it will mean only the increase of the cost of funds, some difficulties at the macro level, but we are more or less sure that ‘this time will be different’, and there would not be a terrible crisis for Hungary." That was at the beginning of 2008.

YPFS: Speaking of the 2007 shock, your reference was to 'this time.' What were the earlier times implied in that statement? Was it a Hungary story earlier? Was it other countries?


First, at the end of the 1970s (finally in 1982), Hungary joined the International Monetary Fund (IMF or the Fund) just two minutes before it had a total collapse. And then, just before the transformation crisis in 1989, after a period of rapid growth, Hungary ran into, again, very serious indebtedness, which it would come out of only in the middle of the '90s. In 1995, there was a very successful consolidation program run by György Surányi (Governor of the central bank) and Lajos Bokros (Minister of Finance), which put the country on a sustainable growth path.

And then, from 2001-2002 the government overspending again led the country to a new crisis. The highest government debt per GDP, and the highest external debt per GDP, among the former socialist countries were in Hungary. We were vulnerable. But we hoped that the markets would appreciate that in 2006, a new consolidation program was announced, and serious austerity measures were taken. However, before the results could be achieved, Lehman Brothers collapsed, and the world changed. It was our fate.

YPFS: In those earlier crises, who were the counterparties Hungary negotiated with?

Király: The International Monetary Fund. Hungary was a very good customer of the IMF from the '80s. We went back several times. We had standby credit several times.

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5 “If a country is unable to borrow abroad in its own currency—it suffers from the problem that we refer to as ‘original sin’—then when it accumulates a net debt, as developing countries are expected to do, it will have an aggregate currency mismatch on its balance sheet.” Eichengreen, Barry and Ricardo Hausmann and Ugo Panizza. The Pain of Original Sin. (August 2003) https://eml.berkeley.edu/~eichengr/research/ospainaug21-03.pdf
times. Often there were long negotiations about new standby credit, and it was avoided. All in all, we had a long experience with the IMF.

YPFS: And in the 2000s, the surge in the private hard currency debt is a major piece of that debt growth. Do you think that there were missed opportunities in that decade? Or is it just that Hungary was in such a hard position from all of the earlier debt burden?

Király: The beginning of the 2000s, at the end of the 1990s, Hungary was really on a sustainable growth path. It was the best period of the Hungarian economy. By the way, it was the first Fidesz government.\(^6\) They came to power with the best economic prospects in the country’s history. The FDI (foreign direct investment) share of the economy was high, but it was used in the productive sector. The growth rate was acceptable, much above the standard Eurozone growth rate, around 3.5%. And the foreign debt and the government debt was significantly decreasing.

In 2002, Hungary was in a terrifically good position. From 2002 on after the elections (again, it’s the politics always in Hungary), the new Socialist government started a so-called socialist reform program during which the government debt more than doubled over two years.

And although they stopped the former generous mortgage loan program of the former government, they let the banks lend to the households in foreign currency. It was really another great missed opportunity to reduce Hungary’s vulnerability, to avoid the worst impacts of a very serious crisis. Hungary joined the European Union in 2004. We had stopped the last capital control already in 2001. And from 2002, the bank lending in foreign currency started. What is even worse, the lending was not in Euro, but in Swiss Franc. Hungary used the highest share for Swiss Franc mortgage loans in Europe.

YPFS: Hungary’s missed opportunity in 2002 raises the question of the central bank’s role as a regulator and of central bank independence. You say, “the government was allowing” (foreign currency lending), but the main authority would be the central bank to allow that, right?

Király: No, unfortunately not. In Hungary, at that time, we had a distributed share of responsibility. The Supervisory Authority was responsible for the risk

\(^6\) Fidesz (the Federation of Young Democrats-Hungarian Civic Alliance) is the party in power today in Hungary, the party Viktor Orban, which originated as an opposition coalition to the communist system and the socialist ruling party and promoted the development of a market economy and European integration. In 1998, the party won the largest number of seats in the National Assembly and formed a coalition government with two other parties electing Viktor Orban as prime minister. Ousted in the 2002 elections, the party regained more than two-thirds of the National Assembly seats in 2010 and has won every election since with Orban remaining prime minister. https://www.britannica.com/topic/Fidesz
management of the banks. And the Ministry of Finance was responsible for regulation. The MNB had no role in regulating or supervising the banking sector.

The only action that the central bank could do and actually, did— our predecessors and we ourselves as well— we proposed serious regulation of FX loans, which was never accepted by the Ministry of Finance or the Supervisors. We were without any possible tool. We were already members of the European Union. We could not forbid the FX lending.

But serious measures could have been taken either by the government or by the Supervisory Authority. These measures were proposed by the central bank. The only thing that the MNB could have done is to increase the reserve requirement on FX deposits or FX loans. But the other truth is that all the banks could have avoided this very, very weak measure. Unfortunately, the central bank was an observer of this.

YPFS: **The Ministry of Economy, including Finance, held that supervisory role over the banks, (as) regulatory supervisor, correct?**

Király: It was a very crazy system. The supervisory authority had a very minor role in formulating the regulation. The state regulators— the Ministry of Finance, which was captured by the biggest bank of the country— did not enact serious regulation against the credit boom.

YPFS: **Twenty years later, does that balance of responsibilities remain, or has that been changed?**

Király: It's significantly changed. It was one of the lessons learned from the crisis. Actually, from 2014, the MNB got the role of the main macroprudential regulator and supervisor. And since then, the central bank can undertake serious regulation concerning bank lending or the banks’ operations. And the MNB retains these tools since.

YPFS: **Was the macroprudential and supervisory role something that you were working on while you were inside the central bank, because that came later, you said?**

Király: Yes. We proposed it. During my time we put together all those supporting materials: Why is the macroprudential role so important for the central bank? Why should macroprudential regulations belong to the central bank? But since we worked during a government that didn't like very much the political background of the governor of the central bank, they simply resisted. They introduced all the regulations after 2013, when the prior management left the central bank. Unfortunately, everything depends on politics.
YPFS: But that government stayed the same, right? It was the same party that implemented the macroprudential regulations later?

Király: Yeah, sure. As soon as we left the central bank and the new governor was nominated by them, they immediately put into effect all those regulations we had proposed in the previous three years. It’s fine. The most important thing is that now these authorities are really in the hands of the central bank, and they live with this.

YPFS: That is interesting timing. Going back to the GFC and the transmission channels you referred to, can you describe the first experience with the government debt market and what that was like for Hungary? What were your challenges and your actions from inside the central bank?

Király: As I mentioned, we felt the crisis already in 2007, but we hoped that a kind of decoupling would emerge. We knew that as soon as something happens on the international financial market, it has some relevance for Hungary.

In 2008 in March, when Bear Stearns collapsed and there was risk aversion increasing in the markets, the Hungarian government bond market immediately felt it. We had some turbulence on the government bond market already in March. But as soon as the Bear Stearns case was solved and the markets felt that there would be more of a quiet period, Hungary came out from this turbulence.

The summer was really very quiet, not only in Hungary, but throughout Europe. Then as you know, on the 15th of September 2008, Lehman collapsed. And then a new tsunami started, which swept away several countries like Iceland, Ireland, Hungary, Romania, Serbia, Ukraine, UK, Spain.

We were not the only one hit by the Lehman crisis, but we were among the first victims of the Lehman crisis, just after the Iceland crisis. One of your questions concerned the difference between Iceland and Hungary. Do not forget that in Iceland, total banking assets as compared to the GDP was somewhere around 600%, 700%. In Hungary it was around 100%. The banking sector was much smaller in Hungary than in Ireland or Iceland, which were very severely hit by the banking crisis.

In Hungary, we had mainly foreign-owned banks. And in the first days of the crisis these banks did not pull out their funds. What’s more, they increased their funding in Hungary in the first days of the crisis. It was a kind of banking crisis, but not so serious as in Ireland or Iceland, because it’s a much smaller banking sector. And from a liquidity point of view, we mainly had problems with the Hungarian banks, such as the OTP Bank and the FHB Bank.

YPFS: In Hungary the focus of the crisis was felt with the government debt. What was your response when you have a crisis of financing the state?
Király: Yeah. It was a liquidity crisis. It happened on the 9th of October 2008. It was a Thursday when almost all the Hungarian financial markets stopped. It's very difficult to say why that day. It was a very, very turbulent time from the collapse of Lehman (on September 15), and especially from the first day of October. Almost every day, something happened in Europe or all over the world.

Why just 9th of October? We will never know. But the reality is that 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, not 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. Local currency, we had no problem—on none of the markets. We had liquidity problem in foreign currency. That's why we say the famous Eichengreen type of "original sin" was committed by us. That is why we applied to the ECB for a swap line, for a euro-forint swap line.

YPFS: Denied by the ECB, right?

Király: Those days the US provided 25 small central banks with US dollar swap line, the ECB provided swap line for Denmark, and Sweden, however, denied for Poland and Hungary. And there is no explanation. We were members of the EU. We were not more risky than these countries. We had a liquidity problem and the ECB denied. A PhD student just recently, I think at the Leiden University, has written about this problem - Why did the ECB deny the swap line for Hungary?8

YPFS: What was the theory? And what did he or she conclude, do you know?

Király: That it's just because of the former distribution of Europe, because we were Eastern countries. No other explanation.

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7 During the GFC, the Federal reserve entered into US dollar liquidity swap lines with 14 central banks as discussed here: Federal Reserve Board - Central bank liquidity swaps. https://www.federalreserve.gov/monetarypolicy/bst_liquidityswaps.htm
YPFS: So, you then have to go to the tri-party rescue package?

Király: When we were refused by the ECB, we immediately applied to the IMF. At that time, it was the annual meeting of the IMF. We applied for an IMF standby credit. And on the first day, the representative of the EU stopped the negotiations because Marco Buti (who would later become one of the main figures of the EU Commission) entered the room and stopped the negotiations, declaring that Hungary was an EU member, and the EU should solve the problems of Hungary. Consequently, we should not apply to the IMF. The negotiations were suspended for three hours before Marco came back and admitted that the EU was not in the position to solve Hungary’s problem.

And what is an urban legend, but I think a true urban legend, is that at that time, the Commission prepared the paper on what would happen if another EU member would face the same problem. And during the Greek crisis, they pulled this paper out of the drawer. Thus, it’s the Hungarian solution that the Greeks got. We were the first and the best example. That’s why it was a joint mission of the IMF and the European Commission.

It was not the troika. There were only two of them in our solution. It was not the troika because Hungary was not a Eurozone member country. That’s why officially the ECB did not take part in the rescue package.

YPFS: Right. Greece was in the Eurozone.

Király: Yeah. Greece was a Eurozone country. That’s why there was already the troika, but they made use of the Hungarian experience.

YPFS: What difference did it make to have a third party, a European Union presence? Or was it just the same as your previous experience with the IMF?

Király: They contributed to the loans. Part of the loan was provided by the EU, but they could not organize the whole package because the knowledge, the technical knowledge was with the IMF. And the largest part of the loan was provided by the IMF as well. In that sense, we were the first. I think we applied for an IMF package and then all the others followed us.

And it was a very quick negotiation. During two weeks, we would conclude the contract. Both parties were satisfied because those reform steps that the IMF had proposed earlier to the government were all included in the contract. At that time, the IMF was really a very strong, but friendly, IMF who could really understand the main problems of the country and could address the real needs of a country.

YPFS: And in the negotiations, that two weeks of arranging the agreement, were there difficult, contentious points and what were the most?
The most difficult point was the forecast. In October 2008, nobody knew what would happen and how serious 2009 would be, how serious the recession would be.

To make a reliable path for the government’s financial assistance for the banking sector, first of all, you had to have a macro forecast. And at that time, the agreement among the different institutions was that in Hungary, the recession would not be deeper than minus 1%. And the government didn't even want to expect this minus 1%.

The MNB’s opinion was that the recession would be deeper, but nobody expected that there would be minus 7%, which was the final figure. So even the IMF could agree that, "OK, let's make the plan for a small recession." In October, it was not yet certain that the liquidity crisis would be followed by such a deep recession in Europe. The US was already in a technical recession, but Europe was not yet.

YPFS: Then the next phase, the recession that comes is deeper. And you go back in six months to the IMF. There’s another market crisis for Hungary, six months later, correct?

Király: Yes, in March 2009, there was a political and economic crisis. The political crisis was caused by the prime minister, Ferenc Gyurcsány, who finally resigned. By that time, he had already lost all his support. So, it was a political crisis in the country evolving in parallel with the economic crisis.

And on the other hand, 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 forbid their banks to help their Eastern subsidiaries. And that's why the Vienna Initiative9, started.

The parent banks in Austria, Belgium, and Italy felt that they did not want to let their subsidiaries go through a liquidity crisis or go bankrupt. The banks asked for the Vienna Initiative which is a four-party agreement among governments, commercial banks, central banks, and international institutions that sat around the table.

We tried to find a solution for the liquidity crisis of Eastern Europe, which was critical in the first month of 2009. It was mainly an FX crisis together with,

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9 The “Vienna Initiative” or European Bank Coordination is a framework for safeguarding the financial stability of emerging Europe. “It brought together all the relevant public and private sector stakeholders of EU-based cross-border banks active in emerging Europe, which own much of the banking sectors in that region and also hold a significant part of government securities.” See Vienna Initiative (vienna-initiative.com). https://vienna-initiative.com/about/vienna-initiative-1-0/overview/
again, a new liquidity crisis. And it was mainly because of the inward-looking shift of the G-20 countries.

But in April of 2009, the G-20 accepted the new agreement that, "OK, we will cooperate, and we will show solidarity towards countries in crisis." I think the new world order started in April of 2009 when the G-20 realized that nobody could solve the GFC by itself. They should pursue international cooperation. They should learn international lessons at international levels. And that it's in the interest of all the countries not to let the vulnerable countries be underwater.

By the way, Madame Lagarde played a very serious role in this. She was always very open towards these kinds of solutions.

YPFS: What influence did the Vienna Initiative have?

Király: The Vienna Initiative, under the auspices of the G-20 decision, could make a very serious impact because of the agreement among the parties—in those countries where the IMF put in its funds, the parent banks would not withdraw their funds. It provided a kind of balance in these countries, stating that the level of foreign funding from private commercial banks achieved in 2008 should at least be kept at 95% or 97% of that level. Taking into consideration a mild recession, they cannot withdraw more funds. In 2009 and 2010, it played a very, very important role in all these countries.

YPFS: And while you are fighting the crisis, is there an understanding or expectation of Hungary adopting the Euro? Is this playing a factor? In Greece, this was a serious factor that was different, that it was in the Euro. But Hungary with the Forint is an independent currency country. What's the assumption, at that time, of these commercial banks and in these negotiations?

Király: Everyone knew that, "OK, we are not within the Eurozone, but we have liquidity problems in FX." From the second part of 2009 or the beginning of 2010, the ECB already provided the swap line for these countries as well. I assume that these developments were very important for the non-Eurozone countries to solve their liquidity problems.

These were mainly liquidity problems and not solvency problems, but liquidity problems in FX are significantly different from liquidity crisis in local currency. And that's why sometimes it looks like a solvency problem, although these countries, even Hungary, were quite healthy economies. And by the way, none of the Hungarian banks went bankrupt during the crisis.

YPFS: And so, these swap lines that were denied in 2008?

Király: Yes. And then provided in 2009 or 2010, I really forgot.
YPFS: This is the shift you're talking about: there's more awareness on the part of the G-20.

Király: Importantly, during the pandemic, during the COVID crisis, these swap lines again became effective. Now it's already a well-accepted fact in Europe that even the non-Euro countries should be provided by Euro swap lines, which is good. It means that we can learn from our former crisis.

YPFS: The appropriateness of the ECB providing swap lines in crisis is an interesting learning. You say then that inside Hungary there's been learning that is institutionalized in the central bank, even within the nationalist populist government?

Király: Yes, all political parties agree, that the macroprudential role should be assigned to the central bank. And the central bank has the right to take macroprudential measures as they did. If you look on the map of the European lending, you will realize that the most strict rules are actually effective in Hungary concerning for example, the LTV (loan-to-value), or the payment to income ratios, or any other aspects of lending. The central bank is really trying to avoid the next credit bubble.

YPFS: And what about the housing policies, the "fiscal alcoholism," your phrase from your article, referring to the underlying debt growth?

Király: In the 2010s the Fidesz-government enacted very generous new mortgage programs, which really increased the indebtedness of the households. The subsidies and the guarantees provided by the government again increased the government’s debt. Of course, Hungary entered the present crisis in a much less vulnerable state than they entered the GFC. But our government, again, spent more than 3% of the GDP in the pre-election period; it increased the government deficit from 2.5% to 9%.

YPFS: The investment profile of Hungary has been recognizing all these facts, but what is the balance? As you said, it's becoming better positioned, less vulnerable, but it is increasing its debt.

Király: Before the pandemic, if you look only at the macro figures, Hungary was in a much less vulnerable position because the total government debt and foreign debt was much lower than before the GFC. The government debt had decreased to 70-75%, while the FX indebtedness of the country was well below 20%. (As of April 2023, it was again above 30%.) So, first of all (in 2014), they converted the former FX mortgage loans to Hungarian Forint-denominated loans for the households, and the government did not increase its FX loans.

So, in that sense, I say that Hungary was in a much less vulnerable phase. But on the other hand, if we scrutinize the monetary and fiscal policy, it turns out that before the pandemic, both were very loose, the loosest in central Europe.
We have just published a paper about the monetary and fiscal policy in Central and Eastern Europe after the pandemic. And according to our analysis, we realize that the very loose monetary and fiscal policy before the pandemic contributed to the post-pandemic conditions of very serious inflationary pressures and high indebtedness.

YPFS: The inflation rates were already high before the pandemic in Hungary, right?

Király: Yes, despite the fact that household energy prices were suppressed. There has been a control for the past 10 years for the energy prices, for the petrol prices. And despite this price control and price controls taken on some food items, the Hungarian official inflation rate is double digit.

YPFS: Isn’t Hungary vulnerable to the energy price because that’s the state budget, state subsidy?

Király: Absolutely. You are right. We are convinced that Hungary is again a vulnerable country. As a small and very, very open economy it is usually vulnerable, and as a matter of fact in Hungary the trade openness (export plus import per GDP) is above 200%. For such a country, the financial stability should be of utmost importance, and without being a member of the Eurozone, we cannot achieve it. We say that to become a member of the Eurozone is of utmost importance, but the government does not think so.

YPFS: Well, staying out of the Euro was their constitutional amendment, it’s now against the constitution, right?

Király: Yes, the Hungarian Forint will be out of the Eurozone. And just now after the new government was formed under the elections, they declared that in the near future, Hungary does not plan to enter the Eurozone. And it means that financial instability will emerge in this country from time to time.

YPFS: This is an interesting dilemma of the attitudes. Because Ákos Bod wrote that a big impact of the GFC in Hungary was that the attitudes toward financial integration, towards Western banks, the Euro and the ECB, turned negative from that experience. And you’ve written along similar lines that Hungary descended into nationalist, populist economics as a result of social tensions. But regarding negative public attitudes to the Euro and western banks and the present regime’s opposition to all of that, what is the effect of inflation on these attitudes, of Forint inflation?

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Király: About the attitudes, it's very interesting because you are right that the Western banks became the culprit of the crisis, they were nominated as the scapegoat who should be blamed for the crisis. But to be a member of the European Union has the highest popularity in Hungary in comparison to the other eastern countries. Hungarians want to be members of European Union. For most of them, they have no big opinion about the Euro, but if you ask the businesspeople, they are pro-Euro. For the average citizen who never spends a day abroad, for him it's all the same, and he doesn't understand that costs of the weak Hungarian currency, which is weak in the sense that it's very volatile.

I think we have the most volatile currency. We have just measured for the past 20 years, and we have the most volatile, and then the Polish zloty. It means that it's always a threat for high inflation. In the 2022 inflation, energy prices do not play as great a role as in other countries, because for the households, the energy prices are suppressed. But the depreciation of the Hungarian currency and the high volatility of the Hungarian currency spurs price spikes and high inflation as a consequence. But average people do not understand it. They're convinced that the high prices are because of the EU and the war, not because of the government. The government is good, and the government defends us. It's quite sad, but that's the situation.

YPFS: Earlier you said that Hungary's macroprudential regulation is among the most rigorous and diligent. Could you explain and elaborate on that, please?

Király: We had learned very serious lessons during the crisis. Number one, never let the households be indebted in foreign currency. Of course, you cannot forbid foreign currency borrowing, but you can regulate it. Presently, you can be indebted in foreign currency if you have your natural hedge; it's already a regulation.

Second, before the crisis, Hungarian banking system had a very special feature, which I always had to explain in foreign conferences, because nobody understood it. Banks had the privilege to provide “variable rate” mortgage loans. Variable rate means that the bank can modify the interest rate of a loan at any time, at any rate it likes. Actually, it's not a floating rate connected to any reference rate. It's not a fixed rate. It's a variable rate in the sense that the bank had the right to modify the unit unilaterally. And they did it. In 2009, the Hungarian households faced not only the depreciation of the Forint, but an increase of the mortgage rate by 2% by the banks.

YPFS: On the outstanding mortgages?
Király: On the outstanding mortgages. Yes. It’s something like the tracker mortgage scandal in Ireland, if you follow it. Something similar or even worse happened in Hungary because these banks simply increased by 200 basis points their interest rates on the current mortgages. It killed a lot of households because increasing by 200 basis points interest rate for a long-term mortgage is roughly equivalent to the Forint depreciating by 20%. Several households went bankrupt because of this step.

After the crisis, we pushed through a new regulation, which declared that mortgages had to be either floating rate or fixed rate. Actually, in Hungary, we have floating rates with a reference rate of the interbank market rates or fixed rate. And actually, the largest part of new mortgage loans are fixed rate mortgage loans, which reflects the principal that the banks should cover the interest rate risk and not the household.

YPFS: Mortgage borrowers in Hungary are offered the rates in reference to foreign currency or in reference to Forint?

Király: In reference to Forint, local currency. Now everything is connected to local currency. But during the GFC, they increased the interest rate of the Swiss Franc loans in spite of the fact that the Swiss Franc interest rates were decreasing to zero. It had nothing to do with the international markets or the financial markets, simply the bank suffered some losses, their cost of funding really increased, and they simply could increase the interest rate to their customers.

YPFS: In the time of a deep, deep recession. What is the impact on Hungary of the financial crisis? How many households suffered? We see the timing of the nationalist government taking the helm in 2010, but is there a snapshot you can tell of the impact of this?

Király: At the worst point of the crisis, more than 15% of the mortgage loans were close to bankruptcy. And all in all, around 500,000 households faced serious problems. Not all of them went bankrupt. They had to sell their houses below the price. And unfortunately, there is no "walking away" regulation. It was a social crisis.

YPFS: Professor Király, I would like to allow in the last minutes we have with you the chance to share lessons learned, if you'd like to reiterate any of the ones you've shared with us or add any others. Do you have any other?

Király: I think we have really mentioned most of them. The most important is the macro-stability of the country, which means that the government should be

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11 See: Explainer: The tracker mortgage scandal (rte.ie).  
prudent. The financial stability of the country means that never let neither the households nor the SMEs to be heavily indebted in FX. Credit bubbles and FX-based credit bubbles are very dangerous that we really learned.

Central banks should be independent but should be responsible for microprudential and macroprudential regulation. It was a main lesson I learned because I was sitting as Deputy Governor responsible for financial stability and I could not regulate the banking sector. I could not stop the FX lending. It was my personal crisis. That’s why I think that central banks should be responsible both for micro- and macroprudential regulation and should be independent.

YPFS: **With regard to the Euro and the volatility cost to the nation, what is the thinking inside the central bank? Is it the same as your thinking?**

Király: It's very interesting because I am sure that within the MNB, there is still a vivid debate about joining or not joining the Eurozone. Actually, the GFC in the past few years gave more strengths to those who are pro-Eurozone, who would like to accede to the Eurozone. But of course, we still have a very strong financial nationalism. It's not only politics. It's within the professionals as well. . . . but in fact, we can’t run independent monetary policy. In our recent paper, we show that, especially in the case of Hungary, the monetary policy is the least independent of all policy tools. We depend on the movements of the big central banks. And during the crisis, we cannot play with our FX because we are so vulnerable. The high volatility of the FX, it's always bad, it results in bad depreciation, and we cannot use it for a good depreciation. That's why I think that without really independent monetary policy, why should we need an independent currency?

YPFS: **Right. But joining the Eurozone is not part of the deal of the current regime, right? It's off the table, out of the question?**

Király: Correct. They are much more financial nationalists, and they declare that we run independent monetary policy in spite of the fact that it’s not true.

Especially they would like to avoid the Eurozone, because entering the Eurozone would mean strict and independent control over the banking sector. Now, members of the current government have significant stakes in a newly created, big Hungarian nationalist bank, not the central bank, but a Hungarian (commercial) bank owned by the government and those oligarchs. Which is really a high risk from a financial stability point of view.

YPFS: **The ownership of the Hungarian bank?**

Király: Yes.

YPFS: **Aren't they being regulated by an independent central bank with macroprudential rigor?**
Király: I would feel safer if the ECB were the regulator. That’s why I would like to join at least the European Banking Union, but Hungary declared that they will not join even the banking union. That’s why they would like to keep Hungary away from the Eurozone and from the banking union and from the central supervision. They supervise it now for themselves. It’s a future bomb within the financial sector.

YPFS: Well, maybe we should leave it there.

Király: Let’s hope. Thank you for your questions.

YPFS: Thank you very much, Professor Király.