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Contents

Against the grain
Hungary may have steered an unorthodox economic policy course but it seems to have worked, pulling the country out of recession and putting it back on a growth path 2

Untapped potential
Foreign investors are starting to appreciate the opportunities available in an economy that has turned itself around 3

Architect of resurgence
As economy minister and central bank governor, György Matolcsy has been one of the leaders of Hungary’s unconventional drive to economic recovery 5

Good times are here again
Hungary’s banking sector is one of the region’s most exciting and innovative, stimulated by greater competition and government moves to tackle bad debts 7

Market with a mission
Growing Hungarian companies are increasingly looking for equity funding. The 150-year-old Budapest Stock Exchange is ready to help 12

Manufacturing on the march
Hungary’s medium-sized industrial firms are becoming more competitive and exporting on a European scale 13

EU funding targets infrastructure
Hungary is set to receive $29 billion in EU funding for development over the next seven years 15

Turning a corner
Data from Euromoney’s survey of country risk suggests economists are increasingly optimistic about the Hungarian economy 16
HUNGARY WAS IN a dark place after the financial crisis. A decade of uncontrolled borrowing had left the central European nation deep in debt. Social and political instability was high; employers were shedding jobs; non-performing loans were rising within the troubled financial services sector.

Scroll forward a few years, and the outlook is considerably brighter. Hungary still faces challenges, not least the issue of what to do about the eurozone, its still-deeply depressed primary trading partner. But growth is back, with gross domestic product set to have expanded by around 3% in 2014. A once out-of-control fiscal deficit has been trimmed to less than 3%, while inflation, thanks in large part to lower oil prices (which also benefit the resource-scarce economy) is practically non-existent.

**Unorthodox but durable**

In its latest quarterly economic outlook, published in December 2014, Barclays pointed to the economy’s sound fundamentals. The government under prime minister Viktor Orban may have pursued unorthodox and unconventional policies to extricate Hungary from recession (but then, so have the central banks of the US, UK and Japan), but, noted Barclays approvingly, these have so far proved to be remarkably durable.

More good news came as the new year ticked in. Fresh jobs data released in the first week of January by the Hungarian National Bank (MNB) showed that just shy of 200,000 jobs were created in the previous 12 months. Leading individuals in the Orban administration, not least MNB governor György Matolcsy, are clamouring for an upgrade of the country’s sovereign credit rating.

Matolcsy is one of the key individuals behind the country’s remarkable turnaround. In an exclusive interview with Euromoney in December, the central bank chief pointed to the importance of reforms launched in the months following the general elections of 2010. New taxes were levied on some industries while other taxes, including those on corporates and income, were trimmed or slashed, helping boost job creation and retail spending. “Without [those reforms], we couldn’t have turned the economy around, returned to growth and, crucially, cut the deficit,” Matolcsy said.

Another clue to the revival of this small, open and business-friendly economy lies in its rejection of the EU’s official economic policy mix. That perhaps helps to explain Brussels’ antipathy toward Hungary’s economic revival – and its flat-out surprise to see Budapest not just return to growth but to thrive within its new skin.

**Growth, not austerity**

Matolcsy points to the importance of pursuing a growth-oriented strategy and rejecting the strictures of austerity. Budapest has blazed its own trail, slashing government expenditure, trimming the social safety net, and making it easier for companies to put people to work. Foreign direct investment has soared as a result, with the country sucking in capital from across the world, notably across fast-growing sectors such as auto and auto-part production.

The future augurs well. Growth is likely to come in at 2.8% in both 2015 and 2016, according to economic consultancy Századvég Economic Research Institute. Economy minister Mihaly Varga tips the budget deficit to be a shade over 2.6% this year. Heinrich Pecina, a senior partner at Vienna Capital Partners, an Austrian private equity group and perennial investor in the country, sees Hungary remaining one of the best-performing economies in Europe. “You just need to look around Budapest to see a city buzzing with business activity,” he says. “It’s a small country but it has great potential – great human resources, very open and with bags of potential.”

**Profound change**

In short, it’s remarkable how far Hungary has come, so quickly. Before 2010 and the arrival of Viktor Orban for his second stint as premier, the country was teetering on the edge of a technical bankruptcy, seemingly destined to cave in to repeated International Monetary Fund requests to accept bailout assistance. Its economy is now all but unrecognizable from those dark days, with growth back, job figures improving every month, inward foreign direct investment up sharply, and annualized retail spending rising for the first time in nearly a decade.

And while there were doubts in some circles about whether the country’s unique growth and reform model would work, no one within the Orban administration is surprised at the remarkable economic turnaround. The trick now will be to keep the recovery on track and to avoid loss of momentum. “If you look at economic fundamentals, I don’t know if they have ever looked as good as they do today,” says László Bencsik, chief financial and strategic officer at OTP Bank, the country’s largest commercial lender.” With the country’s dark days now receding, it’s hard to find anyone that disagrees with that notion.

**Against the grain**

Hungary may have steered an unorthodox economic policy course but it seems to have worked, pulling the country out of recession and putting it back on a growth path.
Untapped potential

Foreign investors are starting to appreciate the opportunities available in an economy that has turned itself around.

HEINRICH PECINA LEANS back in a chair at the Gresham Palace hotel in Budapest and scratches his head. A senior partner at Vienna Capital Partners (VCP), a leading Austrian private equity player, he’s confused by the sometimes unreceptive attitude to Hungary adopted by the outside world. An influential and prominent investor (VCP’s acquisition of the local media operations of German publishing giant Axel Springer was approved in October 2014, the latest in a long line of successful deals), he is baffled at Hungary’s image among some – though not all - foreign investors and commentators.

“The country’s economic development story is there, though it isn’t always recognized outside the region, or outside Europe,” Pecina says, warming to his theme. “Hungary boasts a reliable workforce, and low labour and production costs. It’s in the Schengen region, meaning ease of travel around Europe. Real estate prices are rising again, showing that the property market may have bottomed out, and confidence has returned. There is so much untapped potential here.”

There is much in what he says. Hungary was on its uppers in 2009, fast running out of cash and on the verge of calling in the bailout team at the International Monetary Fund. It never quite came to that, though those were distressing days, admits Gyula Pleschinger, a member of the Monetary Council of the Central Bank of Hungary (MNB). “The country was in a very dark place,” he says. “In fact, it was pretty much the worst-performing economy in the region.” Hungary muddled through, but by 2010 a newly installed government, headed by premier Viktor Orbán, knew that structural reforms were needed to get the economy back on track.

Making it better

To many, the decisions made in the immediate aftermath of those elections were the making – or rather the re-making – of Hungary. New taxes to plug a yawning hole in public finances were imposed on sectors including financial services, telecommunications, utilities and natural resources. Orbán and his council of ministers offset that pain by introducing a series of unorthodox but ultimately successful and business-friendly reforms.

The government, notes Pecina, was probably the only one in Europe to react to the financial crisis by slashing income tax, creating a new flat rate of 16%. “Income taxes went up across Europe in the wake of the events of late 2008, but not here,” he says. Corporate tax in Hungary stood at 19% at end-2014, according to data from KPMG, on a par with Poland and the Czech Republic, the region’s two other leading economies, but below the levels in Austria (25%) or Germany (29.58%).

The aim, in the wake of the 2010 elections, was to boost growth and consumption and cut debt at the personal, corporate and national levels, even while creating a wealth of new jobs – no small feat given the depths to which Hungary, over-leveraged and rudderless, had sunk. Given that some European nations have struggled, in the post-crisis era, to meet a single one of those criteria, Hungary’s ensuing success story is nothing short of miraculous.

Unemployment, which last peaked at 12% in late 2012, stood at 7.3% at end-September 2014, according to data from Eurostat, far below Poland (8.5%) and Slovakia (13%). Péter Virovácz, head of the macroeconomic department at Századvég Economic Research Institute, a Budapest-based think-tank, reckons that 400,000 jobs have been created in the private sector since the financial crisis, many in the resurgent manufacturing sector.

Financial policy minister Gábor Orbán told Euromoney that the key to job creation has been lower taxes, a higher annualized investment rate – which hit 15% in 2014 – and incentives to create new vacancies. “In recent years, we have made every effort to increase labour force participation,” the minister says, notably by slashing corporate taxes while cutting welfare benefits. That made it financially viable for companies to hire - and for individuals to work, rather than living off the state.

Government debt as a share of gross domestic product (GDP) has also fallen sharply, to 2.4% by end-September, against 4% in Poland, while consumption is tipped by Virovácz to surge in 2015 thanks, he says, to “higher disposable income due to higher wages, rising employment, and consumer-price deflation”. Two further boosts are likely to come from bank refunds, following a late-2014 government ruling on pre-
Economy

crisis loans issued in foreign currencies, and a fresh influx of development finance from the European Union.

Other factors point to a country with a bright future. Hungary rose three places year on year in the World Bank’s 2015 Doing Business report, to 54th place, ahead of both Poland (85th) and the Czech Republic (110th). It takes just five days to start a business, beating Poland by nearly a month. Hungary also boasts the highest level of labour market flexibility in Central and Eastern Europe (CEE), according to the Organisation for Economic Cooperation and Development. It ranked 20th in the 2015 World Bank report in terms of enforcing contracts – outstripping its CEE peers and on a par with nations in Western Europe and North America.

Confidence returns
Growth, which tentatively returned in early 2013, is now back in force. One need only wander around the streets of central Budapest, packed with buzzing restaurants and bustling designer outlets, to see clear signs of consumer confidence. Economic output expanded at an annualized rate of 3.7% and 3.9% respectively in the first and second quarters of 2014, slowing marginally in the third. Capital Economics tips GDP to have grown by 3.3% in 2014, the third-highest rate in Europe, and by 2% and 2.5% respectively in 2015 and 2016. The London-based consultancy believes the country is capable of delivering long-term growth rates of around 3%, so long as investment rates remain high, and the still-fragile banking sector can resolve its debt overhang.

Századvég tips growth to come in at 2.8% in each of the next two full calendar years. “Hungary’s macroeconomic position is very sound right now,” notes Virovácz. “We are in the top three in Europe in terms of our real growth rate, and our economy is structurally very sound. Growth in gross fixed capital formation is improving, and the government and the central bank have a lot to do with it.”

In its latest Hungary Quarterly Outlook, published in December 2014, Barclays points to “solid fundamentals”, led by regular current account surpluses, a fiscal deficit below 3% and a high level of growth. “Although some of the improvements have been orchestrated by unorthodox government policies,” the UK bank adds – another nod towards Budapest’s decision to blaze its own trail – “they appear to be durable.”

Virovácz believes that Hungary, by accident or design, has woven together a “special” economic model. “It’s been a bumpy ride at times but from an economic standpoint, it’s clearly working,” he says. “The economy is growing, wages are rising and unemployment is at its lowest rate in a decade.” Exports, which rose by 5.9% year on year in 2013, are set to grow by 7.9% in 2014 and 6.4% in 2015, reckons Századvég. Premier Orbán’s ambitions are to create a regional manufacturing powerhouse bonded tightly to the global automotive, chemicals, and pharmaceuticals sectors. Research and design investment budgets are rising, boosted by generous government subsidies, while EU funding is being channelled into improving the country’s physical infrastructure.

Bumps in the road
There may yet be a few more bumps in the road ahead. Hungary’s overall stock of debt remains high while the banking sector, despite being cleaned up in recent years, is still regaining momentum. A new wave of consolidation is expected over the coming year or two, injecting fresh competition into the sector. And while boosting its productivity rate admirably since the financial crisis, the country still ranks 60th in terms of the world’s most competitive economies, according to the World Economic Forum. That places Hungary close to the regional CEE average but below the likes of the Czech Republic.

Global economic conditions are also both helping and hindering an economy that remains competitive, vibrant and, most important, open to business. On the one hand, notes VCP’s Pecina, “sanctions levied on Russia are hurting Hungary”, particularly its thriving agricultural sector. But, on the other, the sharp fall in oil prices in late 2014 further benefits a resource-scarce economy.

Much will depend on whether the economies of Germany and Austria, both heavily wired to Hungary’s manufacturing sector, can find a higher gear. “If they do well or badly, so does Hungary,” notes Pecina. The MNB’s Pleschinger believes much will depend on whether the eurozone can extricate itself from its ongoing malaise, and prevent a lost five years becoming a lost decade. “More than three-quarters of our trade is with the region, so we are very concerned about what is happening there,” he says.

But all open economies are, particularly in this globalized era, to some extent dependent on the success of trading partners, whether near neighbours or distant lands. These days, everyone connects. Hungary’s great success has been both simple and, in its way, old-fashioned: to take responsibility for its problems, fix them and then focus on boosting trade with economies around the world. Its economic model may be unorthodox but its success, based on higher growth, lower debts and unemployment, and a balanced budget, is undisputed. It’s time for the world to recognize, appreciate and profit from Hungary’s economic success story.

### HUNGARY ECONOMIC OUTLOOK BY YEAR

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross domestic product expansion (%)</th>
<th>Private consumption change (% change, year-on-year)</th>
<th>Net export growth (% change, year-on-year)</th>
<th>Gross external debt ($ billion)</th>
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<td>1.6</td>
<td>-0.1</td>
<td>5.9</td>
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<tr>
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<td>3.3</td>
<td>1.5</td>
<td>8.1</td>
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<td>1.8</td>
<td>4.6</td>
<td>131.2</td>
</tr>
<tr>
<td>2016*</td>
<td>2.8</td>
<td>2.3</td>
<td>4.1</td>
<td>124.6</td>
</tr>
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</table>

*Predictions

Sources: Hungarian National Bank, Central Statistical Office
When György Matolcsy was nominated to the post of governor of the Hungarian National Bank (MNB) in March 2013 by premier Viktor Orbán, the country's finances remained in a fragile state. Hungary had emerged from the global financial crisis intact, but confidence remained at a low ebb. The national stock of debt remained at perilous levels. Banks were lending too little, particularly to smaller and medium-sized companies. A pre-crisis growth model based on consumption and leverage, having vanished, was still to be replaced.

Orbán's decision to promote his economy minister to run the central bank was not without its critics. Matolcsy was viewed by some, particularly in consensus-seeking Brussels, as unorthodox, a non-conformist. In a continent clinging (mostly unsuccessfully) to the strictures of austerity, his adherence to Keynesian growth principles swam against the tide. Yet the appointment proved inspired, showing that bold decisions can pay off. After shrinking in the first three months of 2013, Hungary's economy returned to growth the following quarter and has never looked back. Gross domestic product is on track to have grown by around 3% in 2014, and by 2% and 2.5% respectively in 2015 and 2016, according to London-based Capital Economics.

New levies on the financial services sector irked some foreign lenders, but allowed the government to cut income and corporate tax rates, underpinning growth, slashing debt and building renewed national confidence and stability. In the third quarter of 2014, the government deficit fell to HUF109 billion ($405 million) or 1.4% of GDP, according to the Central Statistical Office, a level bettered only twice in the past 15 years.

Tough decisions

Matolcsy, who is rarely interviewed by the international media, made time in December to talk to Euromoney at the MNB's headquarters in Budapest. The engaging and driven central bank chief, widely seen as one of the primary architects of Hungary's financial resurgence, is nonetheless keen to highlight the continuing importance of tough decisions made in the early days of the Orbán administration.

In the months following the 2010 general election, the government made a conscious decision to blaze its own trail, Matolcsy says, launching “a series of statutory reforms, without which we couldn't have turned the economy around, returned to growth and, crucially, cut the deficit”. Under Orbán, the government “flatly rejected the official orthodox and conventional economic policy mix of the European Commission”, abandoning austerity in favour of a series of structural reforms, resulting in a “stronger economy and political stability”.

While the second of those points may be debatable depending on the definition of political stability (the government has survived the past five years intact, though its popularity has waned, leading to periodic marches across the capital, Budapest) there is little doubting the truth of the former. Or, indeed, the success of the unorthodox measures used to embed growth in a once embattled economy.

Tax shake-up

Hungary has in recent years shaken up its tax system, slashing taxes levied on households and corporates in a push to accelerate growth, while balancing the books by imposing new or raising existing taxes on industries ranging from banks to mining to telecommunications. Lenders bore the brunt of the changes, hit by a direct tax on profits and a broader financial transactions levy that raised the tax on wire transfers and cash withdrawals. Banks grumbled at the time, but few now doubt the success of this radical (at least in modern European terms) attempt to generate growth while balancing the books. Total net external debt, which peaked at 120% of GDP in 2009,
dipped below 70% at end-2014 for the first time since 2006, and continues to fall.

For his part, Matolcsy sees the reforms, designed to create, for the first time in decades, a well-balanced economy with low unemployment and a high rate of economic productivity, as a “successful blend of conventional and unconventional economic policy. On the one hand, we cut both the budget deficit and taxes on labour – both can be regarded as conventional measures,” the central bank chief notes. “On the other hand, we also introduced unconventional measures, such as the bank levy. That blend of policies and measures turned out to be very successful, creating room for an unconstrained, independent monetary policy.”

Another vital facet of the country’s resurgence has been its Funding for Growth (FGS) plan, a low-interest funding scheme based on the Bank of England’s Funding for Lending approach and aimed at boosting lending to local small- and medium-sized enterprises. Despite being the lifeblood of Hungary’s economy, SMEs were suffering from a serious credit crunch by the spring of 2013. Matolcsy remembers bumping into European Central Bank president Mario Draghi in the early days of his job. “He said to me: ‘Oh, you’re the guy from the country with the credit crunch’. The situation was dangerous, critical even.”

The success of the FGS scheme convinced the central bank to split it into multiple tranches. The first phase of the plan, FGS I, which lasted for three months in mid-2013, helped disburse 2.8 billion to smaller Hungarian corporates, according to data from independent think-tank Századvég Economic Research Institute. FGS II, which caps the interest rate banks can levy on loans to SMEs at 2.5%, and which was recently extended to end-2015, is expected to boost lending to SMEs by a further 3.7 billion. Péter Virovácz, head of the macroeconomic department at Századvég, says the plan has “really helped boost growth and improve the fortunes of smaller and mid-cap Hungarian corporates. SMEs are Hungary’s future, and are becoming key parts of the global supply chain” in sectors including manufacturing, agriculture, tourism and retail.

Inflation and interest rates have also been targeted during the Matolcsy era, with resounding success. Core inflation fell to 1.2% in November 2014, the lowest rate in more than eight years, and down from 6.3% in August 2012. The central bank chief expects inflation to remain between zero and 1% in 2015, so long as energy prices remain low. Interest rates meanwhile have systematically fallen during the Matolcsy era, from 7% to 2.1% as of the beginning of 2015. Sharply lower oil prices have caused some countries to react by raising or lowering interest rates, but Hungary, so far at least, has avoided the temptation of cutting rates.

While recognizing the impact of a “serious” price shock in the form of lower oil prices, and the expectation of near-term rate rises in the US and UK, Matolcsy highlights the continuing importance of building a stable economic and financial system. Hungary “badly needs stability in order to offer a stable economic environment for SMEs and corporate and financial investors, which is the reason why we think that - if our assumptions hold - our base rate will remain at 2.1% for the next year or so”, he says. Maintaining loose monetary conditions will also, he adds, help meet the central bank’s medium-term inflation target.

**Banking transparency**

Nor is the central bank governor’s work done. Indeed, 2015 may well prove to be the busiest year of his life. A “fair banking” bill recently tabled in parliament will likely be introduced in the first half of the year, designed to place a ceiling on the measure of income banks can generate from lending, and to create a more transparent financial system. The law, notes László Bencsik, chief financial and strategic officer at OTP Bank, the country’s largest commercial lender, is “good for clients but also for the banks as it creates a very responsible banking system”.

Hungary’s parliament in late 2014 also approved legislation to force lenders to convert $9 billion ($10.7 billion) worth of foreign currency loans issued prior to the financial crisis into forints, the local currency, at the most customer-friendly of two exchange rates. That move will cut banks’ income in the short term but, by writing off the spiralling debts of hundreds of thousands of Hungarian households, should ultimately boost domestic consumption.

Finally there is the expected formation of a $1.2 billion bad bank, overseen by the MNB and designed to buy and house failed commercial real estate loans. The banking sector’s non-performing loan (NPL) ratio stood at 18.5% at end-June 2014, one of the highest in Europe, largely due to bad ‘project loans’ made in the years before the financial crisis. Those failed or failing loans remain a “heavy burden” for lenders, says Matolcsy, who is hoping eliminate a third of all corporate NPLs from Hungary’s banking system by the end of 2015.

**Highly rated**

Hungary’s economic and financial revival has not gone unnoticed. In May 2014, Standard & Poor’s raised its outlook on the long-term sovereign credit rating to stable from negative, citing higher exports and an improved economic environment. The ratings agency affirmed both its outlook and its BB sovereign credit rating in September, and Matolcsy expects the country to enjoy a further upgrade from leading ratings agencies in 2014, in light of the ongoing economic and financial reforms. Notes Zoltán Polyánszky, a senior analyst at Századvég: “Hungary is clearly undervalued in international financial markets, and ratings agencies have failed to acknowledge the country’s fiscal and economic efforts. The country’s rating is predicted to improve in 2015, as a consequence of which risk premiums are expected to decrease.”

Many things have gone right since premier Orbán took office, many of which emanate from the heart of the central bank. Two years ago Hungary remained at a low ebb, depressed by low growth, high unemployment and a still-troubled banking sector. Thanks to the unorthodox and ultimately successful policies of MNB chief Matolcsy, the economy is starting to swell again, boosting growth and creating myriad new opportunities for investors. Hungary was once a country in the gutter, looking at the stars. Now, its economy is starting to shine again.
Good times are here again

Hungary’s banking sector is one of the region’s most exciting and innovative, stimulated by greater competition and government moves to tackle bad debts

HUNGARY'S FINANCIAL SECTOR is on the move again. After years of slow growth and tepid profits, leading lenders are again preparing for a bright future.

Over the past year, a bloated banking sector has been winnowed down, with a brace of foreign investors departing the scene. In December 2014, Budapest Bank, an SME-focused lender previously owned by GE Capital, was absorbed by the state. Five months earlier, MKB, a far larger and better-known banking brand that ran into trouble in the dark days following the financial crisis, was folded into government ownership, having been acquired from Germany’s BayernLB.

Bright future

There are many good reasons to point to a bright future for one of the region’s most exciting and innovative banking sectors.

First and foremost, there is the prospect of greater competition. In the wake of the election of Viktor Orban as premier in 2010, domestic lawmakers, keen to inject fresh impetus into a lagging economy and a sluggish banking sector, wrestled with an industry boasting too many inactive players, many of them sitting on their hands rather than jostling for new business.

Some banks were clearly committed to a market with vast economic potential lying at the beating industrial heart of Central and Eastern Europe (CEE). Others were less determined. BayernLB, having received state aid from the German government following the financial crisis, already had one foot out of the door, while GE Capital had long flagged its global determination to focus on fewer markets. Thus the acquisition of both MKB and Budapest Bank by the state made good and timely sense.

Hungary’s government has made clear its lack of interest in retaining a controlling stake in either – or indeed any – commercial lender. In December, financial policy minister Gábor Orban told Euromoney in Budapest that the state was “conscious of the risks of running a bank”, and did not intend to retain control of either bank. The two outfits will likely be merged, to create the country’s second largest lender, before being sold to private local investors or listed on the Budapest Stock Exchange, with the government retaining a minority stake.

Complete overhaul

The likely creation of a freshly-minted lender combining the heft of MKB and the nimble flexibility of Budapest Bank will also encourage rivals to work hard to secure new business. One of the aims of whittling down the number of powerful local lenders, says György Matolcsy, governor of the Central Bank of Hungary (MNB), is to “create a far more competitive banking system”. He adds: “The entire industry needs a complete overhaul. We need far stiffer competition.”

Financial policy minister Gábor Orban points to the need for another round of consolidation, to take place during 2015, with one or two more foreign lenders likely to exit the domestic market. An industry boasting eight large banks, each with a single-digit market share, is “unsustainable”, the minister says, noting that the number of viable domestic banks will, in the medium term, be whittled down to five or six.

This creates a future scenario in which a select group of lenders emerges, capable of helping build and guide Hungary’s economic future. Most domestic and international analysts believe the winners will prove to be Budapest-based OTP Bank, the largest domestic lender, and a coterie of foreign-based peers, notably Austria’s Erste Group Bank, UniCredit of Italy, and Belgium’s KBC Bank, owner of local unit K&H. A few other names, including CIB Bank, owned by Italy’s Intesa SanPaolo, and Vienna-based Raiffeisen Bank International (RBI), may have to up their game to remain part of Hungary’s banking scene.

New taxes

Orban’s government has played a clever and balanced hand in dealing with the banking sector. A brace of new taxes imposed since 2010 - one directly imposed on lenders, the other levied on all financial transactions, including ATM withdrawals - helped shore up the state’s budget, generating HUF140 billion ($520 million) in annual earnings. Banks grumbled, but the levies were necessary for both the country’s general financial health and that of the banking sector as a whole. In December 2014, premier Orban suggested that the state may trim the windfall tax in 2016 and 2017, noting that he wanted a “new chapter” to start soon for banks, with the state seeking to make their debt burdens bearable.

Another clear focus of the government is to begin the process of unclogging a banking sector still struggling with a backlog of non-performing loans (NPLs). In the years leading up to the financial crisis, many banks directed cheap funding into a raft of industrial projects, many of them in the residential property space. With the onset of the financial crisis, many of those projects faltered or failed. Households had also borrowed at a record pace before 2008, taking out mortgages and retail loans denominated in foreign currencies such as euros or Swiss
francs. For some, the financial crisis proved ruinous, as the local currency, the forint, tumbled in value, leaving households facing spiraling debt repayments.

The outcome was disastrous for all parties. Consumers, struggling to repay their debts, cut spending, crimping economic growth. Banks, faced by rising NPLs, reined in lending, further dampening output and undermining government attempts to get the economy moving again. The reaction from Orban’s government has been unorthodox and unconventional but, equally, carefully considered and compellingly decisive. It has transformed Hungary’s economy into one of the most vibrant in the region, infused the banking sector with a new lease of life and created a new wave of economic growth.

**Ending the debt torment**

Two particular financial reforms stand out. The first, designed to relieve Hungarian consumers from their endless cycle of debt torment, was approved by parliament in November 2014. During the first six months of 2015, lenders that disbursed around €9 billion ($10.65 billion) worth of foreign currency loans to consumers in the pre-crisis years will convert them into forints at the most customer-friendly of two exchange rates.

Markets reacted positively to the news. Lenders will take a hit, typically losing around $400 million a year in earnings due to lower interest income. But, in the end, everyone gains. Banks can get back to their traditional job of making loans to happier customers who, released from their debt obligations, will be free to spend, boosting economic growth. In its latest Hungary Quarterly Outlook, published in December 2014, Barclays noted that by ensuring an equitable solution for all parties, households will see their average monthly foreign exchange loan repayment costs fall by 30%, freeing cash to be saved or spent elsewhere.

Already, there are signs that Hungarian consumers are beginning to open their wallets. “This will help clear more soured retail loans out of the system, all of which is good for the health of the economy, and for the long-term profitability of the banking sector,” notes Péter Virovácz, head of the macroeconomic department at Századvég Economic Research Institute, a leading consultancy.

**Creating a bad bank**

The flip side to that coin is the bad debt stemming from failed commercial lending. Again, the government has a solution. A new bad bank is to be created in 2015, overseen by the central bank and designed to store failed or failing commercial real estate loans owned by leading lenders. In November 2014, the MNB said it had set aside $1.2 billion to buy failed so-called ‘project loans’ that remain a drain on the financial sector and the economy.

Few can argue with this point: at end-September 2014, the corporate NPL ratio stood at 18.5%. The new bad bank will process and sell those loans, further stimulating economic growth and fostering increased lending. “As an initiative the bad bank can play an important role in facilitating the reduction of NPLs,” says László Bencsik, chief financial and strategic officer at OTP Bank. He adds that, as the economic revival continues to strengthen and broaden, “there will be more opportunity to reduce the ratio of bad loans. And as the mortgages and commercial real estate sector starts to grow again, the NPLs in those sectors will be easier to clean up and restructure.”

**Fair regulation**

The final major change facing the banking sector this year is a bill tabled by the government in late 2014, designed to create a healthy banking sector capable of supporting the economy and providing financing for households and corporates. Many of the codicils girding the new fair banking law (FBL) have been in place for years but, notes Gyula Pleschinger, a member of the Monetary Council of the MNB, the new bill “ensures that the financial services sector is regulated for the first time in a proper, fair and transparent manner”. Adds financial policy minister Orban: “It will outline and define what is and isn’t fair. It defines the regime that a consumer loan should follow, making pricing transparent.”

Local and foreign lenders have embraced the new laws, recognizing the paramount importance of restoring credibility.
and fairness to an industry battered by the events of recent years. Lenders say the FBL is a step in the right direction, and it’s notable that even bank CEOs are universally supportive. “Fair banking legislation is positive in that it makes the rules on the financial sector clear, transparent and applicable to everyone,” notes OTP Bank’s Bencsik. “This is good for clients but also for the banks as it creates a very responsible banking system. The fair banking law creates a fair and level playing ground for all players in the banking industry and makes the rules clear and transparent for everyone.”

If it’s broke, fix it
What comes shining through in all of this is a government determined to fix a previously broken sector, to make the industry work for the good of everyone, and to ensure that the next boom does not involve a spike in the type of exuberant lending likely to burden borrowers with a new round of debt. By pricing loans clearly, the government has made it easier for customers to understand their commitments, and harder for lenders to insert clauses that, through accident or design, penalize uneducated consumers.

To the surprise of some (particularly in Brussels, which has remained sullen and tight-lipped in the face of the country’s remarkable turnaround) and the delight of many, particularly in domestic financial and economic circles, Hungary’s banking sector is showing strong and sustainable signs of life. A clear-headed government capable of thinking for itself (and showing a remarkable determination to stay the course) is a large part of the reason for this, as are the lenders that dominate the local banking scene. The likes of UniCredit, Erste and KBC recognize the implicit value in remaining integral to a rising central European manufacturing powerhouse wedded to the economies of Austria, Germany and the wider CEE region.

Real estate picks up
Retail lending is on the rise again, signifying a turnaround in the long-embattled real estate sector. After consecutive years of very low rates of investment in the property space, there is a conspicuous shortage of newly built houses. That should lead to an expected spike in new project lending in 2015, first in residential real estate and then in commercial property, bank chiefs say. Consumption rose sharply last year, with household spending up thanks to robust real wage growth. Add to this a low inflation environment and banks expect retail lending demand to increase this year and next.

Indeed, banks see momentum building across the entire financial services spectrum. OTP Bank’s Bencsik says corporate loan activity rose sharply in 2014, with the lender taking its share of the market to 13%, from 8% prior to the financial crisis. “We will continue to extend our lending activity with Hungarian corporates, with loan growth to domestic corporates rising by between 5% and 10% year on year in 2015,” Bencsik says. “We have higher aspirations with SME corporates, where our loan growth target in 2015 is close to 10%.”

Focus on the middle
Indeed, a rising slice of incremental loan demand this year is likely to come from mid-cap corporates: fast-growing Hungarian firms – the local equivalent of Germany’s famed Mittelstand companies - that lack access to global markets, and for which the primary source of funding is the local banking sector. “From our perspective this is now a major focus for us,” notes Bencsik. Adds economic consultancy Századvég’s Virovácz: “For banks, going forward you will see more profitability being sourced out of the SME sector, as well as the household and the corporate sectors.”

Demand for fresh borrowing is also pouring out of resurgent or long-underutilized or neglected sectors from tourism to auto manufacturing, and pharmaceuticals to agriculture. A fresh influx of EU funds over the next seven years will largely be directed into areas such as infrastructure – creating huge new construction projects – as well as supporting smaller corporates and broadening the manufacturing base.

Equally vital to the banking sector’s turnaround has been a Funding for Growth Scheme (FGS) modelled on a Bank of England project and designed to get banks lending and mid-cap firms borrowing again. Hungary’s FGS plan, divvied up into two tranches totalling $6.5 billion and extended to the end of 2015, channels funding directly through the banking sector, allowing lenders to extend credit to viable corporates on very competitive terms by cutting the cost of funding to zero.

Hungary’s financial services sector has come through great hardship in recent years, as has the broader economy. But after a long winter, spring is finally here. Profits are up, banks’ loan books are expanding again, and lenders are operating in an economy which, thanks to government foresight, and the willingness of lenders to make short-term sacrifices for long-term gains, hasn’t been this sustainably strong in living memory. In Hungary, it’s a good time to be a bank.
MOL GROUP: STRIKING THE RIGHT BALANCE

Hungary’s integrated oil and gas company MOL Group feels it has the right mix of upstream and downstream activities to ride out the oil price slump and continue investing at home, within the region and on the wider international stage. MOL Group Chairman-CEO, Zsolt Hernádi, sets out the company’s future strategy.

MOL Group is a key player in the domestic, global and regional energy market – active in Europe as well as the Middle East, Africa and the Commonwealth of Independent States (CIS). Could you describe your strategy now and for the future? Where do you see MOL’s future across the production, refining, marketing and petrochemicals sectors?

These are very exciting times for MOL Group as we are increasingly seeing the fruits of our labour across all our business segments. I’m glad to say that on a corporate level there’s the right balance between upstream and downstream, ensuring that our company is relatively well shielded against the oil price drop. Therefore we continue to implement our growth projects without delay in both upstream and downstream.

In upstream we are targeting sizeable growth in our international operations, based on our extensive experience in Central and Eastern Europe and with a new internationalized management.

To achieve this growth we have a well-balanced international portfolio with presence in the world’s key oil regions, such as the Middle East, the North Sea and the CIS countries.

Kurdistan is one of the most exciting stories for us, where we are now ramping up production as the field development plan for the Akri-Bijeel block, which we operate with an 80% stake, was approved and commercial production started last November.

We target 10,000 barrels a day (b/d) block production in the short term, which may reach up to 35,000-40,000 b/d by the end of 2015. In the Shaikan block, where we have a 20% stake, gross production recently increased significantly to 40,000 b/d, which is still very far from the total potential of the block.

Another key source of our production growth is the North Sea. In a strategic move to enhance our offshore experience, we entered the region last year with a landmark transaction with Wintershall. This also shifted the country risk profile of our international portfolio in a favourable way. Since then we have added a few more assets and we were also offered four licences in the UK’s 28th exploration licensing round.

Overall, by 2018 we are expecting 30% production growth with our existing portfolio. Additionally, we are actively looking for new acquisition opportunities. From this point of view, lower oil prices could be a good opportunity for companies like MOL, which have a very healthy balance sheet.

In downstream we run one of the most successful integrated business models in Europe. With high complexity refinery assets, an extended wholesale and retail network and integrated petrochemical units, our operation focuses on the landlocked Central and Eastern European market, which still has good potential compared to other parts of Europe. We very much focus on continuously improving efficiency.

In response to the highly unfavourable industrial landscape a comprehensive efficiency improvement programme was launched for the 2012-14 period to increase profitability by $500 million-550 million. The programme concluded at the end of 2014 and we delivered our promises, which was a key factor behind our recent outstanding results. In Q3 2014 MOL Group Downstream achieved one of its best quarterly results. Nevertheless, we cannot rest in such a difficult refinery environment. Therefore we will launch a new programme in 2015. We also see great potential in our growing retail business.

In 2014 we significantly expanded our network as we acquired over 200 service stations from Eni in the Czech Republic, Slovakia and Romania, as well as an additional 44 service stations from Lukoil in the Czech Republic.

We intend to extend our retail network further and strengthen the captive market of our refineries in the CEE region as well as significantly improving the non-fuel part of the business.

Being a landlocked refiner, petrochemicals is a very important part of our value chain. With sites in Hungary and Slovakia, MOL Group is already one of Europe’s top 10 producers of petrochemical products. Nevertheless we continue to strengthen this business segment and further expand our value chain with significant investments. A new LDPE unit will start operations at the end of 2015 at the Bratislava refinery, while in Hungary a new 130 kt/year butadiene unit will be ready by the summer of 2015.

This unit will enable us to enter the promising synthetic rubber...
Sponsored chapter

market by providing raw materials for a synthetic rubber plant also under preparation and planning at Tiszaijáros through a joint venture with Japanese technology and market leader JSR Corporation.

What impact have lower oil prices around the world had on your daily operations and future investment plans? Have you had to cancel any projects, or are you sticking to your existing plans?
I mentioned before that as an integrated oil and gas company we are in a relatively good position: high oil prices are good for our upstream business, whereas low oil prices are good for our downstream margins. We are of course closely monitoring and analyzing developments, but we have to keep it in mind that our investments are for the long term, often spanning decades, and are less influenced by periodic oil price fluctuations. Therefore in our case the 2015 organic investment plans are on track. Nevertheless we follow a disciplined financial policy and we are aiming to finance our investments from our operating cash flow.

This year around 60% of our organic investments will go into our upstream business, mostly to field developments in Kurdistan. So far, we have invested around $700 million there and we are planning to invest a further $300 million this year:

In the refineries, beyond the regular sustainability and efficiency improvement spending we are not planning large-scale investments. Croatia could be an exception to this, where it’s clear that the current setup with two refineries is not economic. If we can agree on the restructuring of the assets, a delayed coking plant in Rijeka to improve complexity and profitability might be built. However, there are several major investments projects going on in the chemical industry that I mentioned earlier: The $400 million LDPE project and the nearly $100 million butadiene plant are under finalization, while the new synthetic rubber unit in Rijeka to improve complexity and profitability might be built. However, there are several major investments projects going on in the chemical industry that I mentioned earlier: The $400 million LDPE project and the nearly $100 million butadiene plant are under finalization, while the new synthetic rubber unit in Rijeka to improve complexity and profitability might be built.

Do you have any expansion plans, such as making acquisitions?
We have a very strong balance sheet for acquisitions, several billion dollars. However we are not in a rush and we will continue to carefully analyze all new potential projects. In upstream we are actively looking at new opportunities, especially in places where we are already present such as the Middle East, North Sea, Pakistan, Russia and Kazakhstan. Current lower crude oil prices may offer better acquisition opportunities for us. In downstream our goal is to further strengthen the competitiveness of our refineries by expanding our retail network.

What message would you like to send out to your shareholders? What would be your overall message to investors about the underlying strength of MOL Group and its future share price?
Times are volatile for energy companies because of the changing oil price, but looking into the future we are very confident. We have a solid financial base and the company is on the right track for growth and value creation. At home and regionally/locally our refineries by expanding our retail network.

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The group has recently been very much in the news, in terms of looking to secure new deals both at home and regionally/locally around the world. Are you looking to raise capital in the future to focus on your expansion strategy?
MOL Group has excellent access to both loan and debt capital markets. MOL has just raised $1.550 million by concluding a revolving credit facility in October. The significantly lower price level of this new facility decreases MOL Group’s funding cost as well as enhancing the group’s maturity profile by introducing the 5+1+1-year tenor. It also creates for MOL Group some additional liquidity, which after the deal amounts to more than $5 billion, comprising cash and cash equivalents and undrawn credit lines. MOL Group usually keeps sufficient liquidity to be able to finance not only its operations even in the case of a market stress scenario but to make the next steps on the strategic growth path if a good opportunity arises.
Market with a mission

Growing Hungarian companies are increasingly looking for equity funding. The 150-year-old Budapest Stock Exchange is ready to help

LAST YEAR WAS a momentous one for the Budapest Stock Exchange (BSE). 150 years after Hungary’s first stock exchange was formed in 1864. Ensuing events diminished the BSE’s relative importance, while the post-Soviet era hasn’t always been kind to the financial reputation of a country long viewed as being at the heart of Europe. But today the city and its stock exchange are on the move again.

The BSE, a leading member of Vienna-headquartered CEESEG, the largest equity trading platform in Central and Eastern Europe (CEE), has just enjoyed yet another solid year. The Xetra trading system has helped provide a stable framework for capital market transactions, including the introduction of iceberg-type orders.

After several years of slow or no new capital markets activity, the BSE welcomed a range of new companies into its fold, in the form of initial public offerings (IPOs) from the likes of healthfood specialist Norbi Update Lowcarb. According to financial information provider Dealogic, convertible bonds worth $637 million were issued in 2014, against none in each of 2013 and 2012, with total equity capital market transaction volumes jumping from just $13 million in 2012 to $665 million in 2014.

The BSE also retains a powerful role in the local equities market. Fully 64% of domestic equity transactions were carried out on the main bourse in 2014. Nor is this a peripheral trading platform. The BSE remains the second most heavily traded market. The majority of trading on the BSE focuses, as ever, on a handful of securities, led by energy giant MOL Group, telecommunications major OTP Bank and rising biotechnology and pharmaceuticals star Gedeon Richter. But local and foreign investors are also free to choose between 49 listed equities, 130 bonds and 28 mortgage bonds. In 2014, turnover on the BSE’s derivatives market reached HUF2.45 trillion.

The next few years will be vital for the bourse’s long-term development. Zsolt Katona, the bourse’s chief executive officer, hopes to continue to build out a “strong local stock exchange concentrating on the needs of domestic investors and corporates using a state-of-the-art trading structure”. The BSE is also set to remain a constant and powerful fixture within the confines of CEESEG, Katona adds, noting that the burgeoning alliance offers international institutional investors easy access to both Hungarian and regional securities.

Bringing in the listings

But the greater – and far more exciting - challenge for executives will be its allure as a potential listing candidate for a new generation of Hungarian corporates. As the broader economy continues to rebound from a crippling recession stemming from the financial crisis, it is beginning to generate an army of fast-growing corporates ranging from software to new energy to biotechnology, with offices across the world.

As these companies eye future listings, the BSE will hope to be central to those discussions. Katona points to “a number of privately held Hungarian firms that are ready for a stock exchange listing. We do have some in the pipeline considering entering the market, some with a market cap of a couple of hundred million euros, and a handful with a potential market cap of more than a billion euros.”

The aim, as Katona is quick to admit, will be to make the BSE as attractive as possible to the country’s rising corporates. Some firms are likely to seek local stock flotations; others, such as Wizz Air, which scrapped then revived its plans for a $200 million IPO in 2014, appear set to pursue dual listings. In the case of the budget airline, with routes across the CEE region, the most likely avenue is a dual stock flotation in Budapest and London. A host of other future listing candidates, likely to include rising firms such as presentation software specialist Prezi, may focus on listing a slice of their securities in New York.

Then there are the state-owned firms set to list shares in the years ahead. This list is likely to include utilities, telecommunications firms and more than a few financial services firms. Having absorbed two lenders – MKB and Budapest Bank – into the state in 2014, government officials are mulling whether to sell them to private sector investors or to merge them and pursue an equity flotation.

“We are optimistic, following recent talks with government officials, that these lenders will be listed on the BSE,” says Katona. “The question,” he adds, “is how attractive the BSE can be, and whether and how we can compete for these companies’ listings with other trading venues. I’m convinced that with our technology, pan-regional scale and the strength of our economy and investor base, we should be able to clinch many if not most of those listings.”
Manufacturing on the march

Hungary's medium-sized industrial firms are becoming more competitive and exporting on a European scale

QUIETLY BUT ASSUREDLY, Hungary is building an economy fit for the 21st century. A resurgent export sector is being driven by rising industrial production. Hungary has become a key production base for automobile majors such as Audi, Mercedes-Benz, Suzuki and General Motors. Beneath the surface, an army of medium-sized industrial firms is on the march. Locally born and bred, they have fast become vital suppliers to leading carmakers, forming a thriving Hungarian version of Germany's famed Mittelstand.

"These firms, notes László Bencsik, chief financial and strategic officer at OTP Bank, the leading commercial lender, "are starting to export and to be competitive on a European scale." That's becoming increasingly widespread, from high-tech and IT down to manufacturing, chemicals and fashion. According to the Hungarian Central Statistical Office, the domestic auto sector generated €15 billion ($17.8 billion) in export sales in 2013, supporting 115,000 jobs across 700 companies.

Ambition and achievement

Hungary is not the only nation in Central and Eastern Europe (CEE) to boast a successful auto sector, built to satisfy the needs of leading European, US and East Asian carmakers. But few can match the country's industrial aspirations, underscored by prime minister Viktor Orbán's determination to see Hungary finally marry ambition with achievement in the modern era.

Manufacturing has had a curiously stop-start existence in the modern era. Under Soviet rule, Hungary was a leading producer-exporter. Companies like Raba made sturdy buses and trucks prized in markets from India to Africa to the Middle East. When the Berlin Wall fell, the likes of General Electric were quick to enter the Hungarian market, taking a stake in local lighting producer Tungsram in 1989. An army of consumer electronics names arrived, from Philips and Siemens to Samsung and LG. Carmakers followed. Audi, present in the country since 1994, makes 2 million engines a year at its factory in Gyor, in the northwest, which also turns out sports coupes and convertibles. In March 2012, Mercedes invested €800 million in a state-of-the-art facility that exports cars to the US, Western Europe and Asia. There are solid reasons behind the country's industrial pre-eminence. Hungary boasts an impressive range of top-class engineering and science colleges, including the University of Szeged and Budapest University of Technology and Economics, as well as a hard-working labour force, and low labour and production costs. Heinrich Pecina, senior partner at Vienna Capital Partners (VCP), a leading Austrian private equity house with investments across the local industrial space, points to the country's abundant and untapped potential. "There is skilled labour galore across the manufacturing, chemicals, engineering and financial services sectors," he says. "And the country's workforce is linguistically skilled: most people speak German or English or both."

Missed opportunities

In many ways, the most curious aspect of Hungary's manufacturing sector is that it isn't already the most powerful of its kind in the region. The past quarter-century has been a tale of breakthroughs and industrial success but also one of missed opportunities. Hungary rightly boasts a solid reputation as a carmaker, but it let some of its regional advantage slip in the 1990s and 2000s, as it focused on growth in areas such as financial services.

Reasserting its place at the apex of the regional auto industry was one of premier Orbán's primary ambitions after the elections of 2010. So far, the plan has proved mightily successful. In its latest quarterly outlook on the country, published in December, Barclays noted that a double-digit annualized increase in the export of machine goods in the first nine months of 2014 was a direct result of new inward investment in the auto sector.

“Hungary’s strong industrial performance is mainly attributable to car manufacturing which is expected to remain a stable base of growth” in the years to come, notes Erste Bank analyst Gergely Gabler, who also points to strong signs of rising growth in the long-embattled construction sector.
The country is also rebuilding trading relations with former Soviet states, and forming new and robust ties with nations from the Middle East to Africa to Asia in a concerted effort to create a robust, export-based economy, while slowly reducing its dependence on the sluggish eurozone. A notable example here is Raba, which now runs a thriving joint venture with Volvo, exporting buses and trucks to Egypt, Russia and the Gulf.

“Hungary-made goods still have a great reputation in former Soviet states,” notes Gyula Pleschinger, a member of the Monetary Council of the Central Bank of Hungary (MNB). “It may have been a mistake in the early 1990s to forget about our trading relations with eastern nations and to focus only on Western Europe. The current government understands the importance of those eastern markets and we have been making large efforts on one hand to increase our trading ties with Korea, China and Japan, and to improve business relations with Russian-speaking and Arabic countries, many of which were forgotten by Hungarian firms in recent decades.”

Branching out

Nor is Hungary likely to become overly dependent on the future prospects of a single sector. A host of fast-growing industries, from agriculture and chemicals to electrical equipment and pharmaceuticals, are growing in power, mostly based in strategic clusters around the north and west. Underpinning it all is a supportive government keen to further the development of its industrial base with subsidies and tax incentives, and a hard-working, highly educated and multilingual populace increasingly likely to seek its fortune at home rather than in Western Europe or North America.

Little wonder foreign multinationals from the US to East Asia to Germany are busily expanding their presence in one of the region’s most economically vibrant and politically stable markets. Incentives are also trickling through the system, supporting not just global multinationals and domestic powerhouses such as energy giant MOL Group, but also an army of smaller corporates now embedded in the local and, increasingly, the regional and global industrial supply chains.

Many of these firms found financial succour in recent years from the central bank’s Funding for Growth scheme, launched in 2013 and recently extended to the end of 2015. The FGS scheme is set to channel at least $6.5 billion in low-interest investment capital to the country’s best and brightest mid-cap firms. The government’s clear commitment to industry, growth and job creation is a considerable comfort to long-term foreign investors – and a further sign of Hungary’s long-term economic potential.

“SMEs are Hungary’s future, and they are increasingly becoming key parts of the global supply chain,” says Péter Virovácz, head of the macroeconomic department at Századvég Economic Research Institute, a leading economic consultancy.

“The country’s main future growth sectors are set to include manufacturing, agriculture, tourism and retail. The government really wants Hungary to become a regional powerhouse. It’s looking to bring in more investment to the manufacturing sector. Our Global Competitiveness Index performance as ranked by the World Economic Forum is improving every year.”

The tech future

Like many emerging markets, Hungary’s next step is to go upmarket, retaining its manufacturing pedigree while becoming a hotbed for industrial and technological innovation. In recent years, Hungary has started to churn out the sort of high-functioning tech firms more redolent of Silicon Valley. Prezi, founded in 2009, has quickly become a leader in cloud-based presentation software, with 45 million users globally and employing 70 people in Budapest and San Francisco. Another local startup, Gravity R&D, specializing in recommender systems, has recently opened offices in San Jose and Tokyo.

It’s high-end firms like these that bode well for Hungary’s future, and highlight the quality of graduates being produced by leading domestic science and engineering colleges. Once upon a time, the best brains in the country would have headed overseas on graduation in search of jobs able to sate their ambition. Some still go but more stay. Salaries may be lower than in Germany or the US, but other advantages – the ability to buy an affordable home, and to own equity in the firm you work for, while remaining closer to friends and family – more than make up for any financial shortfall for many of the country’s brightest young minds.

It’s this marriage of rising production and high-end start-ups that is creating such optimism about the future. “The government is determined to turn Hungary into an R&D hub, as well as a key regional manufacturing centre,” notes the MNB’s Pleschinger. “There’s no reason why both these ambitions can’t be achieved. Hungarians are open-minded, friendly, multilingual, well-educated and hard working. Everything you need to get both of those sectors working in synch and at full capacity.”

Adds Századvég’s Virovácz: “In innovation terms, Hungary is ahead of everyone else in the region. It’s a knowledge-based economy now, and by channelling more funding toward our SMEs, we will create domestic value as well as innovation, and knowledge. Five years from now, Hungary will be a hotbed of innovation, marrying skilled employment and a stable political system with a genuine vision of Hungarian economy and growth. Our future is bright, positive and stable.”
EU funding targets infrastructure

Hungary is set to receive $29 billion in EU funding for development over the next seven years

THE EUROPEAN UNION often struggles for positive coverage in the media, thanks to burdensome regulations and the inflated salaries of an army of mandarins. But it gets some things right. Consider the funds handed to developing countries and provinces by legislators in an attempt to create a more equitable spread of wealth and capital across the region.

Hungary is a classic example. EU funds, sourced from member states, are helping to boost further the business and investment credentials of a country already enjoying a substantial economic revival. Over the seven years to end-2020, €24.5 billion ($29 billion) in fresh capital will be transferred to Budapest from Brussels.

Much of this will be pumped directly into improving the country’s already impressive infrastructure links, particularly in the east and north. Just shy of €2.7 billion will be channelled into improving highways, rail links and urban transport networks, with €400 million earmarked for improving the often patchy broadband network. A further €2 billion is tagged for less visible but no less vital benefits such as improving energy efficiency and wastewater management.

Between 2014 and 2020, €7.73 billion in European funds will be directed into improving economic development and innovation – a broad-based category ranging from research and development and financial instruments to information technology and small- and medium-sized enterprises (SMEs). A further €3.4 billion will help to improve urban development, with just shy of €3 billion to be used for building special investment zones and improving economic conditions in rural areas. These new funding sources will directly benefit Hungary’s economy, as well as the army of local corporates and global multinationals that profit from its status as a regional industrial powerhouse in the making, capable of emulating the manufacturing capabilities of the likes of Austria or Germany.

Hungary has in recent years become an increasingly compelling investment destination for global multinationals. Its economic turnaround helps ensure that top students from the country’s many world-class engineering, technical and economics colleges remain at home after graduation, to search for jobs and opportunities. Past generations would have looked for careers and higher salaries in the US, UK or Germany, for example.

A great place to invest

It’s easy to overlook how important the new EU capital is to Hungary’s future. With Budapest set to match, euro for euro, the capital being extended by Brussels over the next seven years, this is set to be a great place to invest. If all goes well, by 2020 Hungary should be a strong and balanced economy with a high and sustainable growth rate, supported by a sturdy manufacturing base and a burgeoning services sector.

Zoltán Polyánszky, a senior analyst at domestic economic and financial consultancy Századvég Economic Research Institute, notes that a sizeable chunk of the new funds will be channelled into boosting research and design investment, enhancing the competitiveness of local SMEs (in part by helping to direct more bank lending to fast-growing smaller-cap corporates) and fostering job creation. The government, Polyánszky notes, “is aiming to channel the majority of EU funds over the next seven years into sectors that enhance sustainable development”, with the aim of creating a strong business environment implicitly trusted by local and foreign investors and corporates.

EU funds don’t just help to create a more equitable economy and society; they also create new lending opportunities for the financial services sector. László Bencsik, chief financial and strategic officer at OTP Bank, points to a direct correlation between the fresh round of European funding and rising corporate lending. “A larger proportion of these funds … will go into commercial development and lending,” he says. “This will prove to be a fundamental engine of Hungarian growth over the next seven years.” Péter Virovác, head of the macroeconomic department at Századvég, believes previous rounds of EU funding were key to the country’s ongoing economic revival.

There are many reasons for investing in any country, of course. EU funds alone will not draw in the global multinationals, from Samsung to General Electric and Audi to Microsoft, that have made Hungary their home in Central and Eastern Europe – but they certainly act as an added incentive.

Companies invest primarily because they believe in a sovereign growth story – and, as economists note, you will be hard-pressed to find a country with more long-term potential anywhere in the region. Századvég’s Polyánszky points to a cluster of key reasons to invest in Hungary right now, from a beneficial geographic location and an excellent education system to a low rate of corporate and income tax and the government’s clear commitment to manufacturing, in the form of tax relief and subsidies. Viewed from any angle, Hungary’s future looks bright and clear.
FOUR YEARS AGO, Hungary was one of the worst performers in the Euromoney Country Risk (ECR) survey, gripped by recession as it began painful structural reforms while tackling high public and private sector debt. Fast-forward to 2015 and economists are bullish about the country’s economic prospects at a time when other sovereigns in Central and Eastern Europe are struggling.

A combination of factors, including the conflict in Ukraine, the sagging eurozone economy and FX depreciation in the face of a strengthening dollar, have resulted in deteriorating country risk scores across CEE, with major markets including Turkey, Russia and Poland receiving deteriorating risk scores over the second half of 2014. Yet analysts participating in Euromoney’s quarterly survey of country risk have upgraded Hungary as improved economic data suggest the country has turned a corner after its painful experiences post-2008.

Coming out of recession

Hungary suffered a steep recession in the wake of the global financial crisis and entered a period of sharp deleveraging in both the public and private sector. With economic growth averaging -0.4% between 2007 and 2013, Hungary was one of the worst performers in Europe in the ECR survey during this period, as the ability of the sovereign to repay its bulging external debt load was repeatedly called into question.

Yet that threat appears to have been banished, as more positive economic data have brought Hungary an improved assessment from economists participating in the survey. With growth expected by Moody’s to reach 3% in 2014 and 2.5% this year, the economy has responded to government policy actions with rising consumption and investment. Hungary now appears less susceptible to external shocks thanks to a persistent current account surplus, low inflation and a sharp fiscal consolidation, which puts the government on track to achieve its target budget deficit of 2.8% of GDP in 2015. Although the government debt ratio remains high, at approximately 77% of GDP, large foreign exchange reserves now provide an important backstop to the forint and the domestic financial sector, a development that bodes well as Hungary attempts to shake off the economic challenges of the past three years.

Euromoney’s country risk rankings are a valuable guide to how economists view the sovereign risk profile of countries over time. The survey uses a simple methodology to measure political and economic risk, as well as the structural factors that affect a country’s risk profile, applying the same criteria to both advanced and emerging economies. As the survey is compiled on a real-time basis, the ratings often illustrate trends in risk perception earlier than other leading indicators, such as traditional credit ratings.

Ranked 66th safest country globally in the fourth tier of the ECR rankings, Hungary’s risk rating performance in the survey has been driven by three factors. Firstly, analysts’ scores in the survey’s economic outlook indicator have improved sharply in the past 12 months as signs of confidence have returned to the domestic economy. Secondly, Hungary’s score for government finances has also improved in step with the consolidation of public finances achieved by the present administration. Finally, participating economists are much more upbeat about outlook for employment in Hungary and have raised their scores in this crucial aspect of the survey as unemployment has fallen, which bodes well for continued economic recovery.

Work to be done

So what risks remain in 2015? The threat posed by Hungarian households’ large exposure to mortgage debt denominated in Swiss francs and euros is finally receding. Following legislation enacted by the government of Prime Minister Victor Orban, $11 billion of outstanding FX-denominated loans are to be converted into forints, providing a boost to borrowers and the economy. Yet external debt levels in the public and private sector remain elevated in regional terms, meaning that much work remains to be done if Hungary is to insulate itself from external shocks such as a resumption of the eurozone crisis. The risk of deflation is shared by Hungary and many other European countries. Falling prices must be avoided if the reduction in nominal debt levels is to continue, making a reduction in interest rates likely in the near term.

If Hungary avoids deflation while continuing to meet its fiscal commitments, and leads the way in enacting the structural reforms so badly needed elsewhere in Europe, a further improvement in its risk score seems likely over the next 12 months.
Responsibility, planning, self-awareness in life and finances alike – this is the way to go

When we look around our immediate neighbourhood or even in the entirety of Central and Eastern Europe, we find that the majority of people make their financial decisions without the needed knowledge. The consequence: high debt burdens, inadequate savings, unsuccessful investment decisions. This is mainly the result of a low-level financial literacy. As a consequence of demographic, economic and political changes, individual requirements and financial products have become more complex. Under these circumstances, developing conscious awareness and smart decision-making became appreciated goals.

As a responsible financial service provider, OTP Group considers active participation in ensuring the stable development of the region as well as the development of financial culture to be its primary responsibility. Eliminating shortcomings that have evolved over decades is a long term process, thus the bank targets future generations with its educational programmes, through the development of resolutions for children and young people. In order to find the right path easier through the labyrinth of finances, the bank has launched long term initiatives for the development of financial literacy. The shared objective of the programme is to strengthen a sense of individual responsibility by passing on economic knowledge to specific target groups segmented by age-range. This is done in a diverse, simple and perceptible way in order to build a change in point of view, so that the new generation acquires the ability to perceive and retain these values in their day-to-day life and in their financial management habits. The Foundation and institutions of OTP Bank that were established with this goal in mind will familiarize students with economic and financial processes in an enjoyable manner through complimentary training, helping future generations adopt a more responsible approach. In order to reach out to more young people with the complimentary wealth of specialized know-how possessed and developed by OTP Bank and its institutions, the next step is to disseminate the program in the region, that will elevate the Bank’s responsibility in the Central European region and its future to another level.