



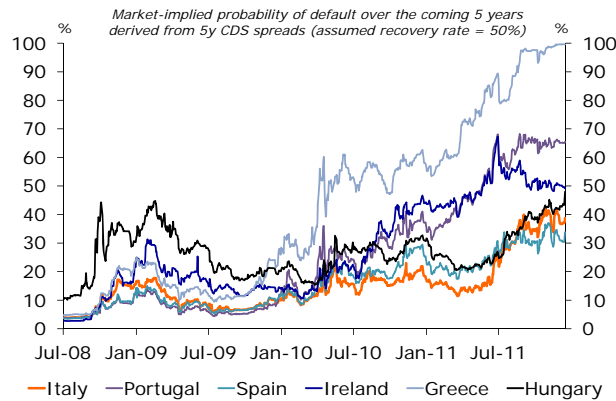
# Hungary – Jumping off a cliff?

*Hungary's government is becoming increasingly autocratic, thereby threatening to undo years of democracy-building, while simultaneously risking a sovereign default*

A number of radical changes to Hungary's constitution have sparked fears that the Fidesz government,

led by president Victor Orbán, is becoming even more autocratic. Under the new laws, the influence of the Fidesz party over both the central bank and the constitutional court increased significantly, as an increase in the number of (government appointed) Central Bank committee members and constitutional court judges, will give the Fidesz party a majority within both institutions. And, the expansion of the Fidesz party's power goes further still. A new fiscal committee, made up of members loyal to the party, gained the right to veto budget proposals, while the committee can also dismantle a government, if it fails to formulate a budget proposal before March 31<sup>st</sup> each year.

**Figure 1: Hungarian default?**



Source: Reuters EcoWin

This gives the Fidesz party the power to force out any new government and decide over public spending, even if it is no longer in government. Also, many religions, including Islam, are no longer recognized by the state and Hungary's main opposition party, the Socialist MSzP, will be held accountable for crimes under the communist regime. Unsurprisingly, many, including 30,000 protesters and a number of Hungary's most prominent intellectuals, fear that by attacking the country's main democratic institutions, the new constitution will undo all efforts to build a democracy. Markets reacted strongly as well, with CDS spreads jumping to 700bps. Consequently, the market-implied probability of default rose to roughly 50% (assuming a 50% recovery rate). Moreover, the value of the forint vis-à-vis the euro dropped to an all-time low. Both developments add to an already precarious economic situation. Since the crisis in 2009, Hungary has been struggling to keep its economy afloat. External debt stood at 107% of GDP in 2011, while public debt stood at a high 80% of GDP. A recent downgrade by rating agencies S&P and Moody's, which reduced the sovereign bond to junk status, further underscores the seriousness of the situation. Indeed, it appears that only the IMF and EU could help the government avoid a default. However, both institutions already warned that they will not come to the rescue, as long as the mentioned laws are still in place.

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