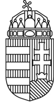

ÁLLAMI
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SUMMARY

of the Audit on the Debt of the Central Subsystem of Public Finances and its Commitments for Periods Exceeding One Year (1294)

In the recent period, several opinions were expressed concerning the IMF loan to Hungary in 2008. In many cases, these opinions referred to a recently published report of the State Audit Office of Hungary (SAO). The main findings of the audit can be found below.

The report of SAO on the 'performance audit on the debt of the central subsystem of public finances and its commitments for periods exceeding one year', published on 23 August 2012, covered the period between 2006-2011. The audit aimed at the total debt of the central budgetary subsystem, the changes in the structure thereof, the interest costs, as well as the effectiveness of the debt management activity.

The SAO report presents that the debt of the central subsystem of public finances increased by 64.2% – from HUF 12,765.6 billion to HUF 20,955.5 billion – between 1 January 2006 and 31 December 2011. The growth rate of the debt was extremely high in 2006 (15.2%) and in 2008 (16.2%), while in the other years it amounted to 4.6-6%. The reason for the extremely high growth rate was the high central budget deficit in 2006 and the depositing of the first loan instalment drawn from the International Monetary Fund (IMF) in foreign exchange in 2008.

The SAO audit revealed that at the time of the signature of IMF's statement of intention related to the loan, no specific plans concerning the amount to be drawn or the utilisation thereof were available, there were only economic policy objectives defined.

The first loan instalment drawn from the IMF loan in November 2008 (amounting to HUF 4.9 billion) was deposited in foreign exchange at the National Bank of Hungary (NBH). The utilisation of the loan in aligment with the objectives (i.e. bank lending, debt repayment) began in April 2009. The interest paid by NBH after the foreign exchange deposit was significantly less than the interest to be paid after the loan already drawn. The interest revenues of the foreign exchange deposit amounted to HUF 11.3 billion, while the interest costs of the drawn loan was approximately HUF 30 billion.

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As a result of the drawing of the first instalment of the IMF loan, the percentage of the foreign exchange debt increased from 28% to 48%. This escalated the exchange rate exposure, and the duration of the loan increased the funding and the novation risks. The negative effects of foreign exchange financing occurred from 2009: foreign exchange risk increased, investor sentiment and credit rating deteriorated. The depreciation of the Hungarian forint increased the debt by HUF 1.657 billion between 2006 and 2011. Of this, exchange losses amounted to HUF 1.165 billion.

The third instalment of IMF loan, i.e. EUR 1.4 billion was drawn by NBH instead of the Hungarian State, according to the decision of the Minister of Finance in June 2009. The reason for the decision was *'to minimise the increase of public debt'*. On the other hand, in July 2009 the Government Debt Management Agency issued foreign exchange bonds in the amount of EUR 1 billion with more unfavourable conditions than the IMF loan drawdown (with a yield spread of 3.95%), according to the decision of the Minister of Finance. This issuance of foreign exchange bonds was not justified, as a deposit of EUR 2 billion originating from the first instalment of the IMF loan was available – found the SAO audit.

The report presents that the significant part of the repayment of the IMF loan due between 2012-2014 is to be effected in 2012-2013, which constitutes a high-risk factor at debt financing. The SAO audit confirmed the viewpoint of the Government Debt Management Agency, stating that *"…the need for the management of public debt did not justify the borrowing of IMF loan within such a short time"*. At the same time, SAO acknowledged the agreement as a fact, however it did not review the concluding thereof.