

Illiberalism on Europe's Periphery: A Critical Macrofinance Tale

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Introduction

Hungary has been Europe's poster child for illiberal democracy for the last decade. But throughout 2022–2023 it faced sustained inflationary pressures that threatened the Orbán regime. This led to unions mobilizing to protest real wage cuts, queues at petrol pumps, ineffective price controls, local capitalists angry at tax increases, and, perhaps most surprising, a public conflict between Viktor Orbán and György Matolcsy, the governor of the Hungarian Central Bank (the MNB), over anti-inflationary measures. Once Orbán's close political ally, Matolcsy denounced the government's price controls as failed socialism. In turn, Orbán first questioned 'overly contractionary' monetary policy, as Erdogan did in Turkey, and then introduced several interest rate caps on credits to selected constituencies, a government incursion into credit policy that overtly undermines the principle of central bank independence. Even more controversially, in its disinflationary efforts, the MNB resuscitated one of the pre-Orbán strategies that it had fought hard to unravel: enlisting foreign finance by offering high returns on short-term inflows into central bank instruments. Orbán had promised Hungarians a new macrofinancial contract that reduced the

distributional benefits accruing to foreign finance from its large footprint in banking and capital markets, including sovereign bond markets (Ban and Bohle, 2021; Gabor, 2010). Instead, Orbán's illiberal state focused on articulating a new state-capital relationship that prioritized the growth of local, regime-friendly capitalists, national ownership of finance alongside a continued reliance on multinational corporations.

This paper unpacks the macrofinancial aspects of illiberal state-capital relationships emerging in post-neoliberal polities. A macrofinancial lens is useful to scrutinize the claim that the Orbán regime is a paradigmatic case of 'authoritarian developmentalism', where a strong state can bend local capital to the strategic priorities of the authoritarian rulers (see Arsel et al., 2021), often by using regime-controlled financial institutions as disciplinary instruments. Paradoxically, this paper argues that Hungary did not go far enough in setting up institutions that could coerce private capital into pursuing the strategic priorities of the state. Rather, Hungary's efforts to build a local capitalist block closely mirror a new state-capital nexus emerging in post-2008 liberal democracies, whereby the state's increasingly expansive ambitions – regarding decarbonization or industrial policy, for instance – do not rely on public investment and ownership, but instead on crowding in private capital through an 'incentives, not regulations' approach that leaves the pace and path of transformation largely at the discretion of private capital. The critical macrofinance literature conceptualizes this return of the state in post-neoliberalism as the 'de-risking state' (see Gabor, 2020, 2023; Dutta et al., 2020). Hungary can be conceptualized as a paradigmatic case of autocratic de-risking: a state that seeks to build up local capital through market-based credit instruments, both via banks and bond markets, rather than through close, strategic control of credit flows and other institutional mechanisms for disciplining private capital. To put it simply, Hungary was not authoritarian enough in its approach towards local and foreign capital when the rise of inflationary pressures demanded it because the state did not have 'authoritarian' macrofinancial institutions that could be tailored towards effective price controls. Instead, a central bank in overt conflict with the government returned to the anti-inflationary practices of the financial capitalism period – and to that period's contested distributional politics that disproportionately benefitted foreign finance.

This paper identifies two distinctive periods in the Orbán regime's macrofinancial politics. In the first pre-inflationary period, the Hungarian Central Bank played a key role in the autocratic de-risking project to reverse decades of dependent financialization, replacing it with financial nationalism (Johnson and Barnes, 2015) and a new distributional politics that shrank the presence of foreign financial capital. In the second period, during the COVID-19 shock and extended inflationary pressures throughout 2022, the MNB reverted to pre-Orbán dependent financialization, undermining a key pillar of Orbánomics. The MNB raised interest rates and offered investors, both local and foreign, substantive profit opportunities through its own deposit facilities to attract capital inflows and engineer a currency appreciation. This triggered an overt conflict with the Orbán government over the contractionary impulses in the MNB's interest and credit policies, culminating in the European Central Bank (ECB) criticizing Orbán's government for its attacks on central bank independence.¹

From dependent financialization to autocratic de-risking

Scholarly analyses of illiberalism frame questions of autocratic durability through the willingness of foreign/domestic capital to re/invest (Camba and Epstein, 2023). This applies well to Hungary's relationship with multinational corporations (MNCs). The Orbán regime secured MNCs' investment, employment, and public relations in exchange for low corporate income taxes (at 9% flat rate, the lowest in Europe in 2022) and other substantive (tax) subsidies. In this area, Orbán preserved the previous liberal approach of aggressively encouraging Foreign Direct Investments (FDIs) through tax incentives, low corporate taxes, weak labor standards, and low wages that created an enclave economy.

The regime made a substantive break with the past in seeking to re-direct Hungarian capitalism away from its dependence on global finance (Piroska, 2022; Sebok and Simons, 2022). Orbán came to power in 2010, as

1 'ECB says Hungary government decree has impaired central bank independence', *Reuters*, 26 April 2023: <https://www.reuters.com/world/europe/ecb-says-hungary-govt-decree-has-impaired-cenbank-independence-2023-04-26/>

Hungary' regime of dependent financialization was in a profound crisis. Orbán pointed to the distributional politics he had inherited and intended to overturn: foreign financial capital dominated banking and capital markets, leaving Hungary and other Eastern European countries vulnerable to downturns in the global dollar financial cycle, and forcing the cost of crises onto Hungarian citizens and businesses (Gabor, 2010; Ban and Bohle, 2021). In part, this distributional set-up had been deliberately supported by central banks, which relied on capital inflows to achieve disinflation targets. Because inflation rates reflected exchange rate dynamics, the fastest disinflation strategy, deployed systematically across Central Europe, was to engineer exchange rate appreciations. In the absence of large trade surpluses that could strengthen the currency, central banks developed instruments to attract capital inflows into local currency assets, such as central bank bonds, sovereign bonds or equity² (Gabor, 2010). But in 2008, a sudden stop in capital inflows after the collapse of Lehman Brothers triggered a rapid currency depreciation, leaving mortgage holders or small and medium-sized enterprises (SMEs) indebted in foreign currencies (euros, Japanese yen, or Swiss francs) with the burden of higher interest rates and a weaker Hungarian forint (HUF), pressures that were then exacerbated by the austerity imposed through International Monetary Fund (IMF) policies.

Orbán's government set out to overturn the distributional advantages enjoyed by foreign financial capital by shrinking its footprint in the Hungarian financial system. In 2012, Orbán proposed to 'create a new economic system: a significant ambition....part of the new model is to have 50% of the banking system in Hungarian hands'³.

The Orbán regime imposed special bank levies and sectoral taxes, forcing banks to assume some of the burden of foreign currency (FX) loans that had previously been entirely left to households and small businesses.

- 2 The MNB issued its own carry-trade vehicles, offering foreign investors access to its risk-free HUF deposits, while simultaneously accommodating foreign banks' strategies to supplement returns by extending mortgage and consumer loans in foreign currencies, predominantly in Swiss francs and euros.
- 3 'The Bank of Viktor Orbán', *Financial Times*, 29 May 2022: <https://www.ft.com/content/f9ba0f39-429d-4d9d-bd2e-fb78b363dfe4>

Hungary also de facto nationalized the 18 private pension funds in the country by ceasing state contributions for citizens choosing to continue with a private pension. By 2015, domestic ownership of banking assets increased to 60%, with two of the country's largest three banks owned by Orbán's political allies (Oellerich, 2019, pp. 39–55). Banks were forced to convert foreign currency (euros, Swiss francs, and Japanese yen) mortgage loans, and then personal and car loans, into local currency. These measures, by far the most comprehensive structural reforms in financial systems across Eastern Europe, were paired with a consistent commitment to achieving and maintaining fiscal surpluses (Matolcsy and Palotai, 2018).

Alongside financial reform, the Orbán government sought to align the MNB more closely with its priorities. Under pressure from European institutions, the government quickly abandoned its early institutional reforms that would have curtailed MNB's independence⁴, and instead placed Matolcsy, an ally, in charge of the bank. Matolcsy's task – to turn recession into growth – would, in his words, be possible 'because the central bank's leadership will be the number one strategic partner of the government'.⁵

This strategic partnership – conceptualized here as autocratic de-risking – was built upon two pillars: (a) credit policies to increase lending to local capitalists (particularly SMEs), and (b) increasing state autonomy from foreign finance.

Building a national capitalist class through autocratic de-risking

The scholarly accounts of Hungary's increased assertiveness regarding credit policy typically connect the growing domestic and state ownership of banking to preferential loans that consolidate the political legitimacy and economic power of the elites supporting the government (Piroska, 2020). Bank loans to Orbán associates were used to acquire control of commercial media or privatized universities.

4 https://ec.europa.eu/commission/presscorner/detail/en/IP_12_803

5 Krisztina Than and Sandor Peto, 'Orban to use Hungary central bank in battle for growth', *Reuters*, 10 January 2013: <https://www.reuters.com/article/uk-hungary-cbank-insight-idUKBRE9090TF20130110>

But such instances of political-driven lending should not be confused with a developmentalist credit policy or authoritarian developmentalism (Artsel et al., 2021). Rather, these mask a broader reliance on autocratic de-risking: supporting local capitalists through market-based credit instruments. In contrast, the (authoritarian) developmental states of East Asia deployed both credit policy for strategic industrial upgrading and state-controlled finance as a tool to push local capital towards industrial priorities (Onis, 1991), understood as the nurturing of local firms ‘across a broad range of major global industries, capable of acting as first-tier suppliers to multinational corporations and even competing head-to-head with them’ (Wade, 2018, p. 525).

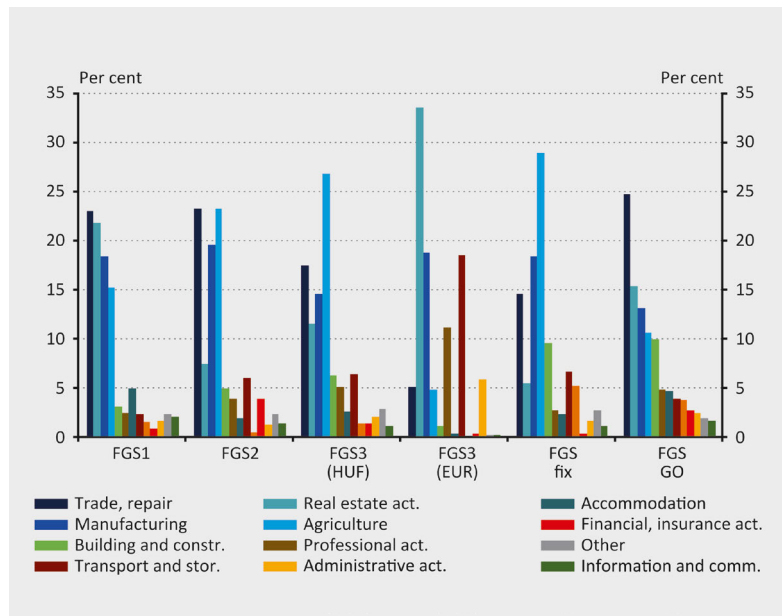
Take the Hungarian Central Bank’s Funding for Growth Scheme (FGS). Through its various iterations, the FGS offers a powerful example of authoritarian de-risking, modelled after the Bank of England’s 2012 Funding for Lending Scheme⁶. Introduced in 2013, the FGS first aimed to increase bank lending to SMEs (see Figure 1). The MNB offered banks refinancing loans at 0%, which the banks could access on the condition that their SME loan portfolio increased, at a maximum of 2.5% interest, for several activities: fixed capital formation, working capital acquisition, FX loan refinancing and prefinancing of EU funds. Cheaper wholesale funding for banks (from the MNB) would translate into cheaper retail funding for SMEs.⁷ The sectoral composition across the multiple FGS schemes between 2013 and 2021 shows concentration in trade/repair, agriculture, and real estate, but less so in manufacturing. Why is this a monetary de-risking approach? The MNB seeks to mobilize private investment by changing the risk/return profile of those investments, but without performance criteria attached to preferential credit, or even a well-designed sectoral allocation strategy. It leaves private investments at the discretion of local capital, which remains in the driving seat. This is not state-led capitalism, as the state – in this case the central bank – does not dictate the quantity of private investment, nor does it target productivity-improving sectors. For this, the state would have imposed performance criteria, and introduced

6 <https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2012/the-funding-for-lending-scheme.pdf>

7 <https://www.mnb.hu/letoltes/nhp-tanulma-nyko-tet-2022-eng-0923.pdf>

other institutional tools to deploy finance as an instrument of compelling local capitalists to support its strategic priorities. Instead, the ‘strategic partnership’ between the government and the central bank was not particularly concerned with *the type* of local capitalists that received support.

Figure 1: Sectoral Distribution of the Funding for Growth Schemes, 2013–2021



Note: by contract amount. The sectoral distribution does not include sole proprietors, but primary agricultural producers are included as part of the agricultural sector.

Source: Central Credit Information System, MNB

(<https://www.mnb.hu/en/statistics/statistical-data-and-information>)

In this sense, the illiberal reliance on de-risking private credit flows suggests that Orbánomics did not set out to build a ‘conservative developmentalism’ but rather a ‘national-neoliberalism’ (Ban et al., 2021). Compare this with the capital-state relationship established by Korea’s authoritarian regime: the state exercised close control over the local firms in strategic industries it chose to support (with preferential credit and other subsidies), ruthlessly penalizing poor performers and only rewarding good

performers (with criteria built, for instance, on export targets) through a complex institutional architecture of coercion that included close control over the flow of credit through state-owned banks, limits to market entry to promote economies of scale, price controls to curb monopoly power (of as much as 110 commodities, including strategic inputs for industrial sectors), and capital controls to prevent elite rent-seeking (Amsden, 1992).

Green lending policies were also organized through the de-risking logic of ‘carrots without sticks’ (Dafermos et al., 2021). Under a sustainability mandate implemented in 2021, the MNB introduced green funding for housing and engaged in purchasing green mortgage bonds, *without* penalties for dirty credit. In contrast, the European Central Bank’s strategy to decarbonize monetary policy developed a framework to tilt the corporate bond portfolio from dirty to green issuers, which, in practice, rewarded good climate performers and penalized bad performers. For instance, the FGS Green Home Programme offered up to HUF 200 billion at 0% wholesale financing to lenders to incentivize green housing mortgages at 2.5% maximum interest rates. According to IMF estimates, subsidized bank lending through both the MNB and government schemes increased to around 30% of total bank credit to non-financial corporates, and 44% for SMEs (Lybek, 2023). Again, these green loans were not accompanied by institutional mechanisms to regularly monitor the carbon footprint of the issuers.

Thus, autocratic regimes do not necessarily follow the developmentalist path even with increased control of domestic credit institutions. Rather, the illiberal Hungarian regime preserved the pre- Orbán strategy of aggressively courting MNCs with incentives⁸: between 2010 and 2016, domestic capital received less than one-quarter of the total subsidies, with the bulk directed towards foreign manufacturing – eight of the top ten recipients were foreign car manufacturers (Camba and Epstein, 2023). This changed little after the COVID-19 shock, as Hungary preserved one of the most generous regimes of subsidies for foreign capital⁹.

8 For instance, in 2014 Hungary allocated 1.63% of its GDP to subsidies, while the EU average stood at 0.72%.

9 This includes a favorable group taxation regime that allows company group members to offset up to 50% of other group members’ negative tax bases (or previous group tax losses): <https://www.pwc.com/hu/en/kiadvanyok/assets/pdf/Invest-in-Hungary-2022.pdf>

The 2008 global financial crisis raised difficult questions for Eastern European countries that had built their banking systems around foreign ownership, often through fire-sale privatizations accompanying shock therapy. Before Lehman's collapse, high levels of foreign bank ownership led to systemic vulnerabilities as large cross-border banking loans supported foreign-currency lending, which in turn amplified consumption, housing booms, and current account deficits (Gabor, 2010). Three of the most vulnerable countries – Hungary, Romania and Latvia – were forced to request IMF emergency loans in 2008–2009.

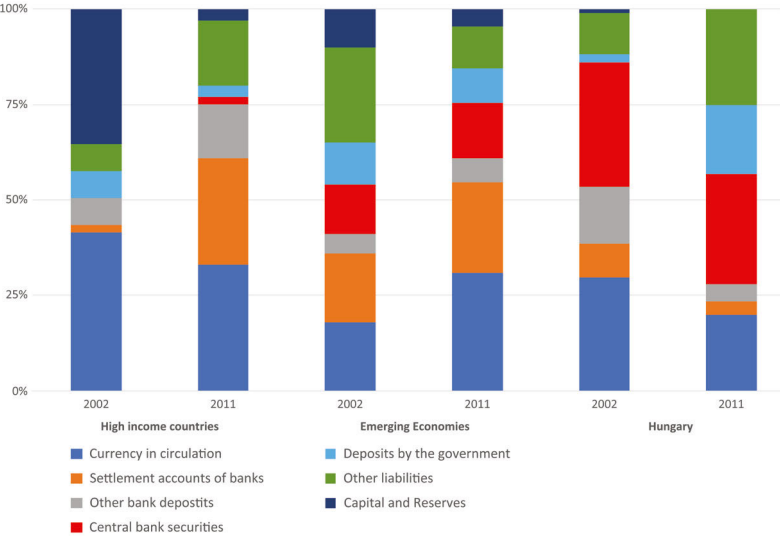
But the post-Lehman implosion was not entirely market made. Rather, central banks across the region had actively sought to deepen their countries' reliance on foreign finance, making it key to disinflation efforts where other monetary/fiscal or structural instruments to reduce inflation were (politically) unavailable. With post-socialist governments hesitant to deploy price controls, often because of external neoliberal pressure, central banks had to engineer exchange rate appreciations that would lower prices, given substantive exchange rate pass into prices through across the region – that is, because of substantial import dependence, local prices are highly responsive to exchange rate movements, with depreciations quickly reflected in higher prices and vice versa. Such central bank engineering took the form of encouraging carry trades and leveraged borrowing in low-yielding currencies (US dollars, euros, Japanese yen) to invest in countries with higher interest rates in Eastern Europe and elsewhere (Galati et al., 2007).

Thus, central banks used their liquidity frameworks to de-risk local currency assets for carry traders, including local (foreign-owned) banks and non-resident investors. Typically, this involved offering sterilization instruments, as central banks issued debt instruments – securities or short-term deposits – to carry traders. Foreign owned banks in Eastern Europe turned this into sterilization games: they borrowed USD or EUR from parent banks/international money markets, sold these to local central banks, and either placed the local currency proceeds in central bank debt or lent them to non-resident investors, who in turn purchased local government bonds (Christensen, 2004; Gabor, 2010). De-risking

structurally entangled the state and foreign finance: central banks could meet their inflation mandate, while Ministries of Finance saw their borrowing costs reduced.

By 2011, when Orbán assumed power, the MNB had issued around 11% of Hungary’s GDP in 2-week MNB bills for sterilization (see Figure 2)¹⁰. The MNB used bills to attract capital inflows, issuing an attractive, liquid carry trade asset for both local banks and non-resident investors, who financed their 6.5% MNB bills with EUR funding at 0.25% rates. As Figure 2 illustrates, MNB bills accounted for 33% of its liabilities, higher than currency in circulation (22%) or commercial bank reserves (4%), and substantively higher than emerging economy averages at around 16% in 2011. Put differently, the MNB dedicated more of its balance sheet to bribing carry traders into supporting disinflation than to traditional activities like issuing currency or supporting the interbank payment system.

Figure 2: The Structure of Central Bank Liabilities for Selected Countries



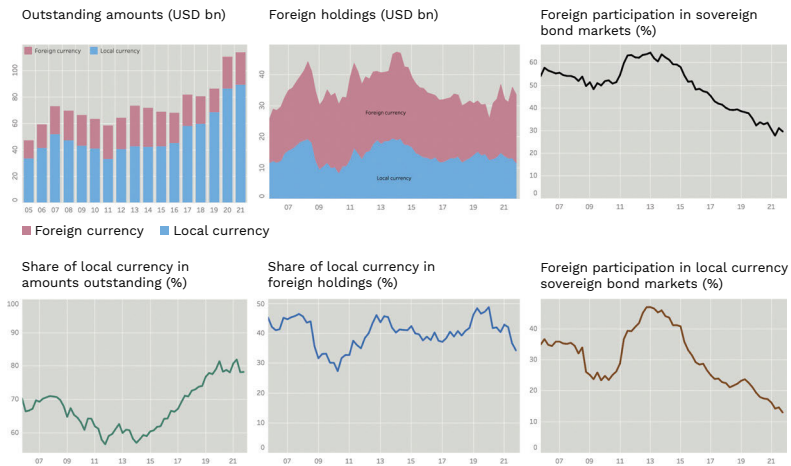
Source: MNB (<https://www.mnb.hu/en/statistics/statistical-data-and-information>)

10 See <https://www.mnb.hu/letoltes/erhart-kicsak-kuti-molnar-monostori.pdf>

In distributional terms, the MNB validated and amplified the profitability of foreign finance, directly through carry trade sterilizations, and indirectly by encouraging local banks to prioritize short-term market activities at the expense of long-term relationship lending to local capital.

The systemic vulnerabilities of state dependency on foreign finance came into sharp focus after the Lehman collapse. Foreign ownership of HUF sovereign bonds fell significantly as foreign investors dumped sovereign bonds to protect carry returns (see Figure 3), intensifying pressures on the exchange rate. Parent banks threatened to withdraw cross-border loans to subsidiaries, seeking to prop up their own balance sheets, vulnerable to the European Banking crisis. The 2008 IMF Stand-by Arrangement and the European Bank Coordination 2009 Vienna Initiative sought to protect the increasingly controversial distributional status quo.

Figure 3: Foreign Ownership of Hungarian Sovereign Debt, Local and Foreign Currencies (2007–2022)



Source: Bank for International Settlements (BIS) data

Under Matolcsy's leadership, the MNB sought to radically change the distributional politics of the central bank through its 2014 Self-Financing Programme. This involved three interventions: a) shift government bond issuance to local currency; b) reduce dependency on foreign demand for

sovereign debt; and c) change the central bank's liquidity management to both reduce dependency on carry trades and shift commercial bank demand from sterilization instruments to HUF sovereign bonds.

In cooperation with the Government Debt Management Agency (ÁKK), local currency sovereign debt in total outstanding increased from under 60% in 2014 to around 80% in 2021. In this approach, the MNB followed the G20 Local Currency Bond Market Initiative that advocated for local currency bonds to improve the ability of developing countries to withstand volatile capital inflows. Having nationalized private pension funds, the MNB sought to foment local bank demand for HUF sovereign bonds. To do this, it reoriented liquidity management towards shifting the carry trade activities of banks to the HUF sovereign segment and broader lending to the real economy. The central bank first replaced its main sterilization instrument, the 2-week MNB bills, with a two-week deposit, a less liquid instrument that carry traders could not easily trade. It then extended the term, reduced the issuance frequency, and capped the volume of sterilization deposits (see Figure 4), seeking to 'crowd out excess bank liquidity' from the central bank policy instrument into HUF sovereign bonds:

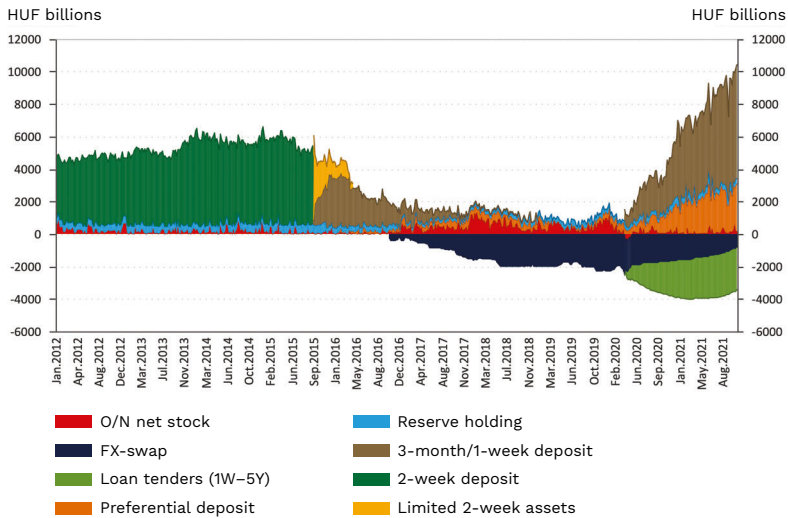
By crowding excess bank liquidity out of the policy instrument, the steps described above are expected to facilitate a decline in market yields. Having been crowded out, excess liquidity may flow into the interbank market and into the government securities market beside the Bank's other deposit instruments; therefore, the resulting interest rate effect is likely to arise in these sub-markets, supporting the Bank's schemes to stimulate bank lending and the Self-Financing Programme.

MNB (2020: 12)

In sum, the authoritarian shift in Eastern Europe set out to overturn the distributional politics of the previous liberal regimes, which had benefitted foreign capital, without a radical shift in the structural logic of state interventions focused on mobilizing private capital into policy priorities. Orbán promised a new economic system and delivered in as far as it shrank the distributional benefits for foreign finance. But the system failed to

dismantle the old growth model because it essentially preserved the old tools of de-risking: along with aggressive subsidies for MNCs, the most notable policy interventions saw the MNB swapping the beneficiaries of its de-risking from foreign carry traders to local capital, organizing interventions to encourage higher lending to local capitalists or middle-class households (for instance, mortgage lending) and, simultaneously, higher private demand for HUF sovereign bonds.¹¹

Figure 4: Selected MNB Liquidity Instruments, 2012–2021



Source: MNB

In parallel, businessmen with ties to the Orbán regime set up a large network of private equity funds through which they took ownership of Hungarian assets. Private equity funds raise capital from accredited investors, like pension funds, and qualified clients, like high net-worth

- 11 The COVID-19 pandemic saw the MNB adopting a range of unconventional policies from the de-risking toolkits of other European central banks (Gabor, 2023), including unconventional sovereign and corporate bond purchases alongside an extension of the FGS.

individuals, and invest on their behalf. Private equity funds can invest in companies or infrastructure assets, typically through an aggressive approach that seeks to maximize short-run profits. But profits are not the only attraction for investors in private equity funds; secrecy also plays an important role, as private equity funds are not subject to public disclosure requirements. Recent reports¹² suggest that private equity funds owned by close Orbán associates have controlling stakes in Magyar Bankholding (MBH), the superbank that the Orbán regime intends to deploy as a national development bank, as well as in large food and manufacturing companies, and a substantive portfolio of infrastructure assets, including hotel chains, properties in Budapest, recycling plants, highways, and camping sites.

A radically different institutional arrangement would have involved the MNB directly targeting sovereign yields or deploying credit policies as an instrument to push (local) capitalists into adopting state priorities when market conditions changed. The pitfalls of this strategy would become apparent with the global inflationary pressures in the wake of the COVID-19 pandemic.

Inflationary struggles undermining autocratic de-risking

Inflation in Hungary accelerated to its highest level in decades starting in early 2021. From 2.7% year-on-year in January 2021, it peaked at 24.5% in December 2022 (see Figure 5.1). As in other European countries, external shocks played an important part, including COVID-related supply chain disruptions and the surge in commodity prices, primarily energy and food, further amplified by Russia's war in Ukraine. For instance, the cost of imported energy more than doubled within a year, with the overall imported energy bill reaching around 10% of GDP in 2022. But specific domestic circumstances – related to the fault lines of the autocratic de-risking strategy to build a national bourgeoisie – are important to understanding why Hungary's inflation was the highest in the EU, nearly double the EU average, and well above regional peers.

12 <https://www.direkt36.hu/en/oriasi-vagyonokat-rejtettek-el-kormanykozeli-korok-de-most-egy-hivatalos-adatbazis-leleplezte-oket/>

Figure 5.1: Harmonized Index of Consumer Prices (HICP)

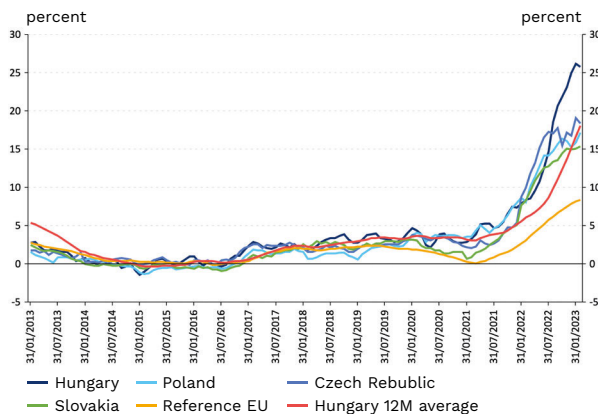
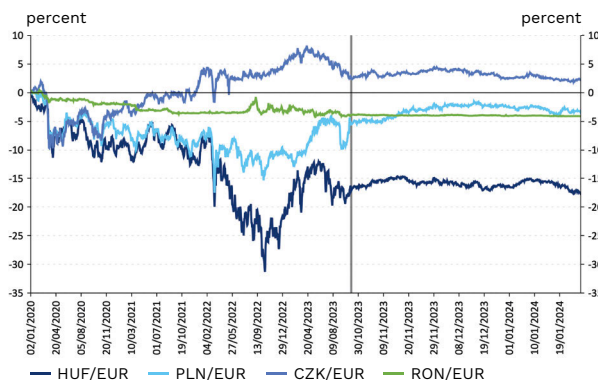


Figure 5.2: Exchange Rates (Feb. 2019=100)



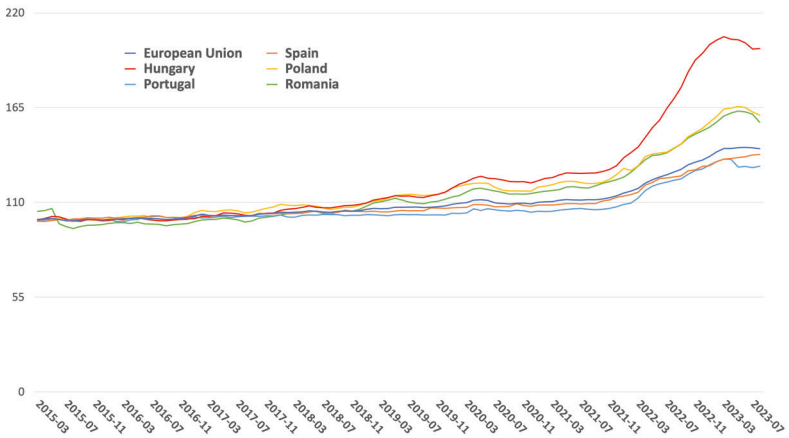
Note: HUF=Hungarian forint, PLN=Polish zloty, CZK=Czech koruna, RON=Romanian leu, EUR=euro

Source: MNB (<https://www.mnb.hu/en/statistics/statistical-data-and-information>)

First, Hungary saw a faster and sharper exchange rate depreciation throughout 2021 and particularly throughout 2022. By October 2022, the HUF had depreciated by nearly 40% on 2019 values, significantly more than currencies in Poland or Romania, and in stark contrast with Czechia, whose currency appreciated (see Figure 5.2). Against tighter global financial conditions, Hungary-specific dynamics included a widening current

account deficit led by expensive energy imports, and disputes with the EU that added to risk perceptions, intensifying pressure on the exchange rate and imported inflation. Indeed, the European Commission notified Hungary that it was considering the suspension of EU disbursements to Hungary for breaches of the principles of the rule of law in April 2022, and by December 2022 the European Council agreed to withhold EUR 6.3 billion in budgetary commitments¹³, roughly a third of the Hungarian government's outstanding foreign currency debt.

Figure 6: Food Harmonized Indices of Consumer Prices, Selected Countries, 2022–June 2023 (June 2015=100)



Source: Eurostat

Second, food prices rose at the fastest pace in the EU, despite selective price controls introduced in February 2022 (see Figure 6). Processed food prices contributed the most to the rise in core inflation. An unusually severe drought, the Russian invasion of Ukraine, and depreciating exchange rates that increased the price of imported food all played an important role, amplified by the sellers' responses to price controls: in a bid to preserve margins, distributors and retailers raised prices on other products. The Hungarian state's attempts to design and implement effective price

13 <https://www.consilium.europa.eu/en/press/press-releases/2022/12/12/rule-of-law-conditionality-mechanism/>

controls were thus ineffective, in part because the autocratic de-risking approach paid little attention to creating state institutions that could compel local capital to adopt strategic state priorities.

Table 1: Price Controls at Sectoral Level, Hungary

		Coverage	Description	Cost borne by
Household utility price	2014-	All households	Prices of household gas and electricity fixed at around 24 and 75 euros per MWh, respectively, for all levels of consumption. In August 2022, the cap was increased for consumption above the national average to price levels closer to market rates, which are to be adjusted quarterly.	Utility companies and government
Motor fuels price	Nov. 15, 2021 to Dec. 6, 2022	Resident privately-owned vehicles, taxis and agricultural machinery	Price of petrol and diesel capped at HUF 480 per liter (EUR 1.3 euros at 11/15/21 exchange rate). Coverage was initially universal, then narrowed to residents only in July 2022. The cap had been extended twice to end-2022, but eventually ended earlier than planned as it led to supply pressure and closures of petrol stations.	Wholesalers
Food price cap	Feb. 2022 to Apr. 30, 2023	Universal	Prices of granulated sugar, wheat flour, sunflower oil, pork leg, chicken breast, and 2.8% cow milk capped at their 10/15/21 levels. The cap has been extended several times, and the list was expanded in November 2022 to include potatoes and eggs capped at end-September retail price.	Retailers
Mortgage interest	Jan. 2022 to mid-2023	Variable rate mortgages, and those with fixation dates through June 2023	Mortgage rates capped until June 30, 2023 at October 27, 2021 levels for mortgages with short- to medium-term interest fixation periods. Analysts estimate that capped mortgages amount to about 2.3 percent of GDP or 22.7 percent of own funds (total bank lending for housing purchases was 8.1 percent of GDP at end-August 2022).	Banks
SME interest	Nov. 15, 2022 to Jun. 30, 2023	All SMEs with variable interest-rate loans	Interest rates on HUF-denominated business loans to SMEs capped at the reference rate as of June 28, 2022. The MNB estimates the cost to banks at about 0.1 percent of GDP.	Banks
Large deposits interest	Nov. 21, 2022 to Mar. 31, 2023	Large depositors with at least HUF 20mn in deposits	Interest rates on some large deposits capped at the average 3-month T-bill yield. The government's objective is to divert those funds toward government securities.	Large depositors (foregone interest)
Student loan interest	Jan. 2023-	Student loans	The interest rate on student loans that are subject to interest will stay at 4.99 percent as of January 2023, when it would otherwise have increased to 10 percent for 100,000 borrowers. Other student loans are interest free.	State-owned student loan provider

Source: IMF Country Report (February 2023), p. 6 (<https://www.imf.org/-/media/Files/Publications/CR/2023/English/1HUNE2023002.ashx>)

Price controls went beyond food items, as the IMF (2023) reports in detail (see Table 1). Their faulty design had significant macroeconomic consequences, forcing the government into abrupt U-turns that fed

inflationary dynamics. Take motor fuel. Initially, the government imposed a cap well below market prices (November 2021), in an attempt to contain the passthrough onto consumer retail prices. As foreign companies cut fuel shipments, the state-owned Hungarian gas and oil company MOL struggled to meet demand, resulting in shortages, queues, and a critical supply condition. The government then abruptly lifted the cap in December 2022, which in turn generated an additional inflationary impulse, as fuel prices jumped by 27% year-over-year and contributed close to 2 percentage points to Consumer Price Index (CPI) headline inflation year-over-year that month. This exacerbated the inflationary dynamics of the August 2022 decision to lift price caps on household energy utility closer to market rates.

By April 2023, the Orbán government scaled up efforts to preserve the legitimacy of its authoritarian rule. First, it extended price controls to 20 basic food categories, in parallel with measures to force retailers to cut prices of at least one item in each group. Second, it set out to build new institutions to discipline capital: it announced a state-backed price monitoring system that could push businesses towards disinflation, traditionally a mark of developmentalism. But the political will to transition from autocratic de-risking to developmentalism proved short-lived. In June 2023, the government announced it planned to terminate all food price controls beginning in August 2023, while its online price monitoring system¹⁴ – designed in a joint working group involving the Ministry for Economic Development, the Competition Authority, the Ministry of Agriculture, the Central Statistical Office, the Ministry of Justice, and the Consumer Protection Authority (formed in March 2023) – shifted the disciplinary tools from the state to the market. Consumers were to use it as a transparency tool to make informed purchase decisions.

The Hungarian government's mishandling of the price caps – a reflection of international supply conditions as well as the weakening of its ability to preserve strategies of autocratic hedging – exacerbated inflationary pressures. It also forced a tightening of both monetary and fiscal

14 John Woods, 'Hungary's brand new price monitoring system kicked off: here is how it works', *Daily News Hungary*, 7 February 2023: <https://dailynewshungary.com/hungarys-brand-new-price-monitoring-system-kicked-off-here-is-how-it-works/>

conditions and set the stage for an overt conflict with the central bank, which was advocating for a return to the strategies and distributional politics of the neoliberal era.

Figure 7.1: Central Bank Rates and 3-Month Interbank Rates in the Region

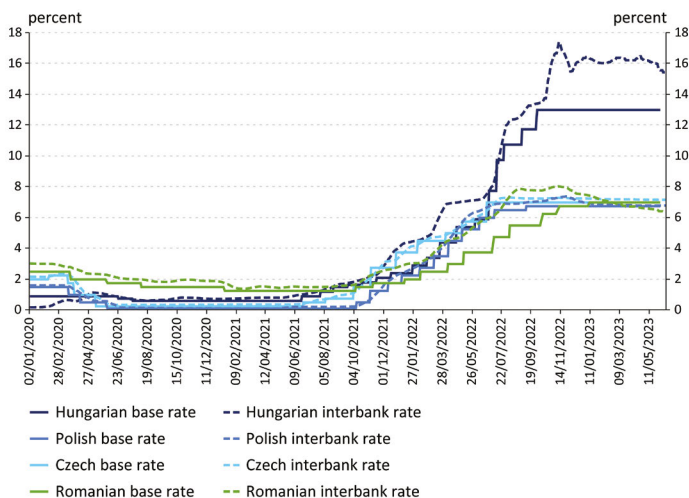
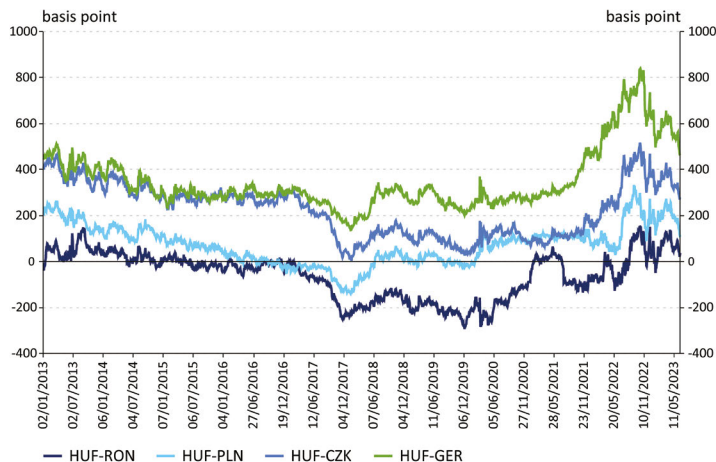


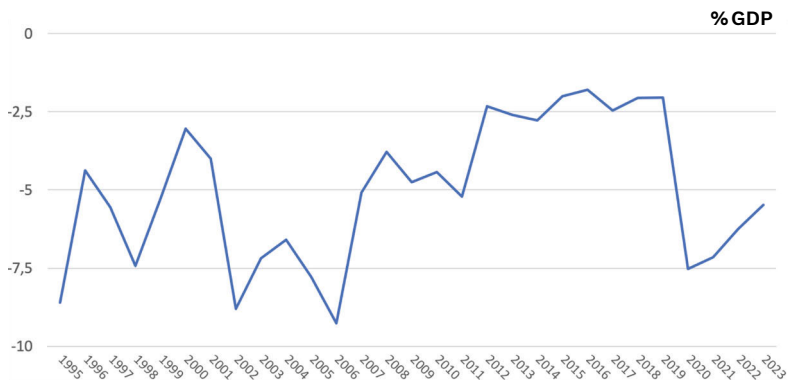
Figure 7.2: 10-year Government Bond Spreads, Selected Countries



Source: MNB (<https://www.mnb.hu/en/statistics/statistical-data-and-information>)

On the monetary side, the MNB started to raise policy rates from mid-2021. By mid-2023, the base rate (the policy rate of the central bank) was around 15%, nearly double the regional average (see Figure 7.1). Interbank interest rates also increased substantively, as the MNB returned to pre-Orbán carry-trade strategies in October 2022 (see more in the next section). Fearing the impact on the housing market and the legitimacy of the regime, the Orbán government decided to intervene directly in credit policy, overstepping into the formal domain of the central bank. The government introduced several price controls on credit products, capping mortgage rates, SME interest rates, and student loan rates (see Table 1).

Figure 8: Budget Deficits as Share of GDP, 1995–2023



Source: IMF statistics (https://www.imf.org/external/datamapper/G_X_G01_GDP_PT@FM/HUN)

Borrowing conditions also tightened for the government. The spreads between 10-year Hungarian government bonds and German, Polish and Czech bonds increased throughout 2022 (see Figure 7.2). By end of 2022, Hungary's borrowing costs were higher than Romania's, reversing the historical trend of the preceding five years. In part, this reflected the MNB's decision to taper outright purchases of government bonds, unwinding its unconventional monetary policy measures. At the same time, the Hungarian government decided against substantively reversing the loose fiscal stance of the COVID-19 pandemic before the April 2022 elections (see Figure 8). The May 2022 announcement of windfall taxes on banks,

insurers, large retail chains, the energy industry and trading firms, telecom companies, and airlines, intended to cover the costs of energy price caps (and military expenditures), did little to return the intra-year negative cash balance of the central government towards 2021 levels. The fiscal stance tightened by 2023, to an estimated 5.4% of GDP, driven by lower-than-expected revenues generated by the overall demand shock affecting the Hungarian economy. By May 2023, Hungary entered a technical recession, as demand for imports shrank at the fastest pace in a decade, in tandem with net lending. The ability of Orbánomics to deliver to its constituencies was increasingly questioned, not just by trade unions and small business owners, but also by former political allies.

The Matolcsy U-turn: Questioning Orbánomics, and back to the distributional politics of financial capitalism

The government has not found the keys...we cannot overcome this energy price explosion and inflation crisis in the old ways...communism already showed that price caps don't work...the system collapsed, let's not return to it with such techniques.

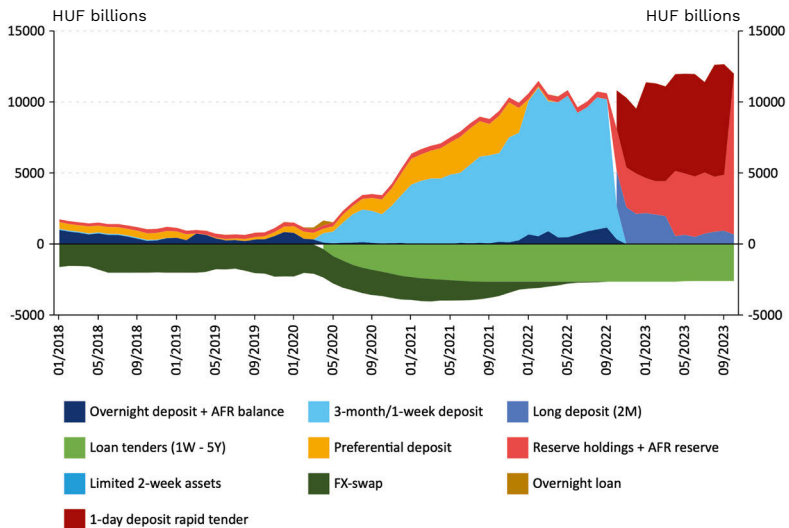
György Matolcsy, MNB governor, January 2023¹⁵

It is worth remembering that one key pillar of Orbánomics sought to untie Hungarian capitalism from global finance. This would weaken the infrastructural power of finance (Braun, 2020) and, perhaps more importantly, reckon 'with the role of capital in underpinning contemporary political and economic structures' (Sebok and Simmons, 2022 p.12). The strategic alliance between the central bank and the government would play a key role, with the central bank seeking to untie its monetary policy operations from carry traders, which were viewed as destabilizing instruments of financial dependency. The very first measures taken by the Matolcsy-led MNB sought to create local demand for HUF sovereign bonds by pushing foreign investors out of MNB instruments.

- 15 'Hungary's soaring inflation puts squeeze on Viktor Orbán', *Financial Times*, 28 January 2023: <https://www.ft.com/content/6074bbc2-247b-46a1-bcce-03c464cec8b4>

But the COVID-19 shock and inflationary pressures combined with the failure of outright price controls saw the MNB return to the techniques of financialized dependency. The bank opened access to investment funds and to its growing range of unconventional instruments, such as the Bond Funding for Growth Scheme (BFG) and the government securities purchase program, and to its collateralized loans. It also expanded the range of eligible collateral to include investment shares of HUF securities and real estate funds.

Figure 9: Selected Assets and Liabilities of the MNB



Source: MNB (<https://www.mnb.hu/en/statistics/statistical-data-and-information>)

The more controversial move came in an emergency decision on October 17, 2022, as the Hungarian forint was rapidly depreciating. The MNB introduced a one-day deposit facility paying investors an 18% interest rate, well-above the official 13% policy rate, and held deposit tenders daily – effectively bribing both local and foreign investors to scale up carry-trade inflows into its deposit facility, reviving the liberal de-risking

strategy it had deployed throughout the pre-Orbán years. By February 2023, the MNB was attracting around USD 45 billion in one-day deposits, rewarded at an 18% annual interest rate, and a smaller volume in MNB Discount Bills (see Figure 9). Ironically, while Matolcsy was publicly denouncing the government for returning to 'communist' practices of price controls (conveniently ignoring their widespread use in capitalist countries after WWII), it quietly returned to the liberal practices of attracting investors for MNB instruments to defend the exchange rate and ease inflationary pressures.

Historically, authoritarian regimes often chose to preserve or even strengthen central bank independence. Independent central banks can pursue disinflationary policies while shielding the government from the associated political backlash, and, equally important, can protect a pro-capital distributional status quo that benefits capital owners closely associated with ruling elites (Aklin et al., 2022). But not all authoritarian regimes evolve alike. Before the COVID-19 pandemic, the MNB's turn to autocratic de-risking did not seek to replace the market, but rather reoriented the logic of steering private capital that once benefitted foreign finance to benefit local (small) businesses and middle-class households. In that sense, the strategic partnership with the Orbán government prioritized a different section of capital. But persistent inflation weakened that strategic partnership, prompting the MNB to return to disinflationary strategies dependent on foreign finance and igniting a conflict with the government over the distributional implications of high returns for carry traders that were hurting the economy.

This conflict with a more assertive, independent central bank took a rather unexpected turn. The Orbán government decided to intervene directly in credit and interest policy with a broad range of interest rate caps on mortgages, SMEs and student loans, and, critically, with sterilization interventions. The Orbán government sought to replicate the MNB's early strategy to crowd local demand from MNB policy instruments into government debt: it capped the interest rates on large demand deposits under a year at the average 3-month Treasury Bill (T-bill) yield in November 2022, in order to restrict big local investors and banks from depositing cash in central bank facilities or purchasing MNB bills. In response, the

ECB issued a legal opinion that the Hungarian government had infringed on the independence of the MNB under Article 130 of the Treaty on the Functioning of the European Union.¹⁶

Notably however, the Hungarian government quietly conceded that the techniques of dependent financialization were necessary for the disinflation strategy, by continuing to allow foreign institutional investors access to the MNB's one day deposit facility via FX swaps with Hungarian HUF lenders.

Conclusion

The macrofinancial choices and politics of illiberal regimes matter. They tell us what kind of relationship with private capital such regimes champion, and the conditions under which these relationships might threaten, rather than support, the overall legitimacy of authoritarian rule. Through this lens, the Orbán regime should be understood as an example of a weak authoritarian regime that makes capitalism profitable for multinationals and local business allies but is unable or unwilling to construct state capacity to set performance targets or broader mechanisms to force capital into strategic priorities.

16 <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52023AB0010&qid=1682527131068>

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