

Hungary (the Republic of)

Foreign LT: BBB+/Negative, Local LT: A-/Negative

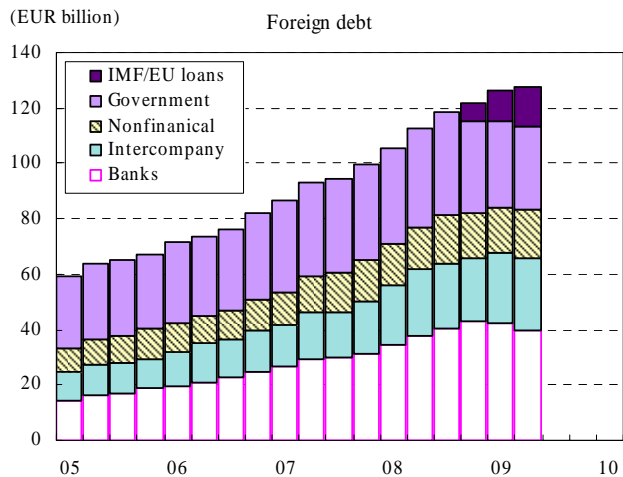
<Rating Perspective>

Positive Factors

- Improved external liquidity position supported by the IMF loan package
- Diversified economic structure bolstered by its deepening economic ties with European countries
- Expanded production capacity rendered by increased investment amid inflows of FDI and EU subsidies

Negative Factors

- Heavy foreign debt burden primarily by the private sector
- Large general government debt stemming from a chronic fiscal deficit
- The worst economic recession since the country's socioeconomic transition



<Updated: from September to December, 2009>

Positive Factors

- The IMF completed its fourth review under the Stand-By Arrangement (SBA) on December 18
- Based on the agreement with the IMF, the 2010 budget plan aimed at narrowing the fiscal deficit to 3.8% of GDP was approved in parliament on November 3
- On November 19, the parent banks of the six largest foreign banks in Hungary reaffirmed with the IMF and European Commission to maintain the capital adequacy ratios of their subsidiaries at appropriate levels and keep their exposure at least at 95% of the September 2008 levels
- Real GDP (seasonally adjusted) in the July-September quarter of 2009 fell by 1.8% quarter-on-quarter, a modest improvement from the 2.0% contraction in the previous quarter
- Thanks to the financial assistance from the IMF and EU, foreign exchange reserves at the end of November 2009 swelled to EUR28.6 billion from EUR16.9 billion at the end of October 2008
- Trade balance in the first ten months of 2009 ended in a substantial surplus equivalent to 4.3% of GDP
- The National Bank of Hungary (central bank) cut its interest rate four times by a total 175bps in September, October and November, bringing it to 6.25%

Negative Factors

- The fiscal deficit in the first eleven months of 2009 was equivalent to 4.2% of GDP, reaching 113% of the full-year target set by the government
- Unemployment rate at the end of October 2009 rose 2.1 percentage points to 9.9% from a year earlier

<Outlook and Points to Watch>

Progress made on the reforms pledged to the IMF

(1) Economic contraction eases moderately

The Hungarian economy plunged into the worst recession since the country's economic transition. Since the April-June quarter of 2008, real GDP contracted for six consecutive quarters (QOQ) due mainly to the economic downturn in its major European trading partners and the country's tighter credit condition. The real GDP contraction eased somewhat to 1.8% (QOQ) in the July-September quarter of 2009 from 2.5% in the January-March quarter. Industrial output in September and October in 2009 grew 3.7% and 1.8% month-on-month respectively. By contrast, the unemployment rate began rising sharply at the beginning of 2009, reaching 9.9% in October, up 2.1 percentage points from a year earlier. The current economic development is broadly in line with the government's projection of a 6.7% negative growth for 2009. A slight economic contraction will continue in 2010. While fiscal austerity measures and the continued tight credit condition may drag down domestic demand, economic recovery of the country's major trading partners and improved export competitiveness brought by the Hungarian forint's steep depreciation will help exports improve modestly. Economic growth is expected to recover in 2011, to around 3%, slightly lower than the country's growth potential. Meanwhile, the consumer price inflation in November jumped to 5.2% temporarily year-on-year from 3.7% in June following increases in VAT and

the excise tax in July. The inflation rate is likely to stay around 3% in 2010 due mainly to weak domestic demand. The NBH cut its interest rate four times by a total 175bps in September, October, November and December, bringing it to 6.25%.

(2) Austerity measures to rein fiscal deficit in 2009 and 2010

The minority government led by Hungarian Socialist Party (MSZP) with the backing of the SZDSZ-Hungarian Liberal Party (SZDSZ) has so far made significant progress on its policy commitments made to the IMF and EU. The fiscal austerity measures including a pension cut, lower salaries for public employees and taxation changes have already cleared parliament. The measures are expected to cut expenditures by Ft400 billion (1.5% of GDP) in 2009 and Ft950 billion (3.5% of GDP) in 2010. Based on its agreement with the IMF, the government has won parliamentary approval of its 2010 budget plan aimed at narrowing the fiscal deficit marginally to 3.8% of GDP from 3.9% in 2009. While these measures have proved effective in curbing expenditures, revenues have been decreasing considerably on continued economic contraction. As a consequence, the fiscal deficit in the first eleven months of 2009 already reached 4.2% of GDP, or 113% of the full-year target. JCR expects that the deficit in 2009 will be slightly bigger than the government target. Barring reversal of the current fiscal policy by the next government after the general election scheduled for April 2010, the deficit in 2010 is most likely to meet the target thanks to recovery of revenues and continuation of the austerity measures.

(3) External liquidity position bolstered by financial assistance

The financial assistance totaling EUR20 billion (over 18% of GDP) committed by the IMF, EU and World Bank has helped to stabilize the country's external liquidity position. Following completion of the third review under the SBA on September 25, 2009, the IMF disbursed SDR50 million (about EUR53.7 million) and decided to extend its SBA by six months to October 2010. On December 18, the IMF completed the fourth review under the SBA (The government has said it will not draw the SDR725 million or EUR788 million it is entitled to). The government has so far withdrawn around EUR14 billion from the IMF and EU. This helped to boost the country's foreign exchange reserves to EUR28.6 billion at the end of November 2009, which is 1.37 times as much as its short-term foreign debt at the end of June 2009. The trade balance in the first ten months of 2009 ended with a substantial surplus equivalent to 4.3% of GDP. Nonetheless, the country's external debt burden remains heavy, with the foreign debt standing at EUR127.6 billion at the end of June 2009, up 4.8% from the end of 2008, due mainly to the IMF/EU financial assistance (the debt would have decreased 6.5% to EUR113.1 billion without the financial assistance). Given the improved external liquidity position and the moderation of the global financial woes, JCR considers that the government will be able to secure the necessary external financing, bar recurrence of financial turmoil.

(4) Fiscal stability requires continued watch

Major Hungarian banks, except OTP Bank, are the subsidiaries of big European banks. The parent banks have so far kept their exposure in Hungary. But there remains the possibility that they may reduce their exposure should they run into difficulties. Bank supervision has been reinforced in the financial reforms based on the IMF agreement. On November 19, the parent banks of the six largest banks in Hungary reaffirmed with the IMF to maintain the capital adequacy ratios of their subsidiaries at appropriate levels and keep their exposure at least at 95% of the September 2008 levels. A rising unemployment rate and the forint's depreciation that added to foreign currency-denominated liabilities owed by households and companies (which account for more than 50% of the total loan balance) may lead to an increase in nonperforming loans, which in turn could adversely affect the country's financial system.

Main Economic Indicators: The Republic of Hungary

		2005	2006	2007	2008	2009 (f)	2010 (f)	2011 (f)
(Convergence criteria)	Criteria							
1.CPI (annual average)	0.8%(note)	3.5	4.0	7.9	6.2	4.0	3.5	3.0
2.10 year government bond yield	4.8%(note)	6.6	7.1	6.7	8.3	n.a.	n.a.	n.a.
3.General gov't fiscal balance/GDP(ESA95)	Below -3%	-7.8	-9.2	-5.0	-3.4	-4.0	-3.7	-2.8
4.General gov't debt/GDP(ESA95)	Below 60%	61.7	65.6	65.8	72.0	79.0	82.0	83.5
Real GDP growth rate	(%)	4.2	4.0	1.2	0.6	-6.5	-1.5	3.0
Unemployment rate (year-end)	(%)	7.2	7.5	7.3	7.9	10.5	11.0	10.5
Current account balance/ GDP	(%)	-6.8	-7.7	-6.8	-7.0	-1.2	-2.0	-3.3
Trade balance/ GDP	(%)	-1.6	-2.3	0.2	-0.1	3.1	2.6	1.6
Net Foreign Direct Investment/ GDP	(%)	4.7	3.2	1.6	2.3	0.2	1.3	1.4
Forex reserves (excl. gold)	(EUR mln)	15,451	15,841	15,804	26,725	27,500	29,500	30,500
Forex reserves / monthly Imports (G&S)	(months)	3.0	2.7	2.4	3.9	5.1	5.1	4.7
Forex reserves/ short-tem external debt	(times)	1.5	1.5	1.1	1.4	1.3	1.4	1.4
External debt/ GDP	(%)	75.5	90.9	98.4	112.3	142.6	145.3	140.7
External debt/ exports (G&S)	(%)	110.0	118.2	123.2	141.0	187.7	192.1	184.7
Public external debt/ exports (G&S)	(%)	44.5	44.5	42.9	45.7	69.3	71.4	66.9
Debt service ratio	(%)	30.9	29.5	26.0	23.2	36.1	32.9	28.5

(Note) Figures for criteria 1 and 2 are average between November 2008 and October 2009. Figures for 2009, 2010 and 2011 are based on the projection made by JCR
(Source) The European commission, The National Bank of Hungary, and Ministry of Finance

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