

## Hungary (the Republic of)

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

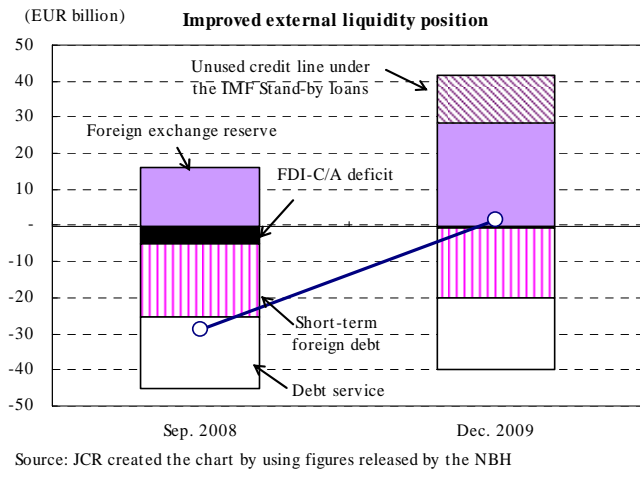
### <Rating Perspective>

#### Positive Factors

- Improved external liquidity position supported by the IMF loan package
- The continued primary balance surplus
- Diversified economic structure
- Expanded production capacity rendered by increased investment on the back of FDI and EU subsidies

#### Negative Factors

- Heavy foreign debt burden primarily by the private sector
- Large general government debt



### <Updated: from December to March, 2010>

#### Positive Factors

- Following the completion of the IMF's fourth review under the Stand-By Arrangement (SBA) on December 18, 2009, the fifth review was provisionally agreed on February 15, 2010.
- Foreign exchange reserve at the end of January 2010 swelled to EUR 32.6 billion, equivalent to 1.7 times of the short-term foreign debt at the end of September 2009.
- The general government fiscal deficit in 2009 (cash base, excluding local government) ended up with 3.6% of GDP, lower than its plan (3.8%) and planned to be reduced further to 3.3% in the recently approved 2010 budget.
- The current account balance in the first nine months of 2009 turned into a marginal surplus to 0.6% of GDP from a 5.7% deficit from a year earlier
- The National Bank of Hungary (central bank) cut its interest rate by 50bps in February 2010 to 5.75%. The cumulative interest rate cuts since November 2008 was a total 275 bps.

#### Negative Factors

- The real GDP in the October to December quarter of 2009 contracted 1.3% quarter-on-quarter, a seven consecutive QOQ contraction.
- Unemployment rate at the end of 2009 reduced to 10.7% for the first time to decline following the financial turmoil.

### <Outlook and Points to Watch>

#### All eyes are on the fiscal policy after the election

##### (1) On March 5, JCR has affirmed its ratings and revised their outlook to stable

The ratings are primarily supported by its improved external liquidity position, continued primary balance surplus and diversified economic structure, as well as the expanded production capacity rendered by growing infrastructure investment on the back of a massive EU subsidies and foreign direct investments. On the other hand, the ratings remain constrained by a relatively large foreign debt owed primarily by the private sector and a high level of general government debt to GDP ratio. The outlook of the ratings has been revised to stable. The large scale financial assistance from multilateral institutions and the subsiding global financial turmoil have helped stabilize the country's external liquidity position. The government has made so far steady progress in implementing reforms of the public finance and financial systems to honor its commitments to the IMF and the EU. In the general election in April 2010, major opposition center-right Hungarian Civic Union (Fidesz) is highly likely to win a parliamentary majority. JCR assumes that the 2010 deficit may widen moderately, but the government will keep the current tight fiscal policy on the basis of the country's commitments made to the IMF and EU and Fidesz's target of the euro adoption on the earliest possible date, as well as the newly implemented *Fiscal Responsibility Law*.

##### (2) External liquidity position improves despite heavy external debt burden

The financial assistance totaling EUR20 billion (over 18% of GDP) committed by the IMF, the EU and the World

Bank and the easing global financial woes have helped improve the country's external liquidity position. The government thereby has reestablished its access to the international financial markets and hold ample foreign currency deposits. As agreed with the IMF and the EU, the government has carried out reforms of the fiscal and financial systems and successfully completed the fourth review in December 2009 (the fifth review was provisionally agreed to take place on February 15, 2010). JCR forecasts that the current account balance, which had posted an average annual deficit equivalent to around 7% of GDP from 2006 to 2008, will turn into a marginal surplus in 2009 as imports fell faster than exports. The foreign exchange reserves swelled to EUR 32.6 billion at the end of January, 2010, which was 1.7 times as much as the short-term foreign debt at the end of September 2009 and 6 times as much as the average monthly imports in the first nine months of 2009. Nonetheless, the county's external debt burden remains heavy with the foreign debt standing at EUR129.5 billion at the end of September 2009 or around 130% of GDP.

### (3) Modest contraction expected in 2010 after the worst recession since the county's economic transition

The Hungarian economy in 2009 plunged into the worst recession since the country's economic transition partly because of the implementation of fiscal austerity measures but mainly because of the global financial crisis and the subsequent economic downturn in its major European trading partners. The economy contracted 6.3% in 2009, but it started easing already from the April-June quarter of 2009. It is highly likely that the economy is projected to settle with a marginal contraction in 2010. Meanwhile, the consumer price inflation jumped to around 5% year-on-year in July 2009 following increases in the VAT and excise taxes, but is likely to stabilize due mainly to subdued impacts of the tax hikes and continued weakness of the domestic demand. NBH has cut its interest rate by a total 575 bps since November 2008. The rate currently stands at 5.75%. The country's financial system has regained its stability. Hungarian banks have so far remained profitable after absorbing rising credit costs and kept their capital at adequate levels. While credit costs will inevitably continue rising at least throughout 2010, the banks have sufficient capacity to absorb them.

### (4) Next administration is likely to continue keeping fiscal austerity measures

Even after falling into a minority status in spring 2008, the government has made progress on the fiscal reforms committed to the IMF and the EU. The reforms include a pension cut, lower salaries for public employees, cut in housing subsidies and tax amendments. Regardless of considerable economic downturn, these measures helped contain the general government fiscal deficit in 2009. The deficit is highly likely to come to 3.9% of GDP, in line with the revised fiscal plan in May 2009. Hungary is one of a few EU countries that run the primary balance surplus. The ratio of the general government fiscal debt (ESA95) to GDP, which is estimated to surge to nearly 80% at the end of 2009 from 65.7% in 2007 due mainly to the loans provided by the IMF and the EU, is likely to stabilize in coming years.

In the coming general election, the Fidesz is highly likely to win a parliamentary majority. Regarding a post-election fiscal policies, the Fidesz recently hinted that the fiscal deficit in 2010 may widen from the current government's target on inclusion of one-off items such as debt consolidation of public companies and other factors. JCR considers that the 2010 deficit may widen moderately, but the current tightening fiscal policy will be maintained on the basis of the country's commitments made to the IMF and the EU and the Fidesz's target of euro adoption on the earliest possible date, as well as the newly implemented *Fiscal Responsibility Law*. JCR will watch the development.

## Main Economic Indicators: The Republic of Hungary

		2006	2007	2008	2009 (f)	2010 (f)	2011 (f)
<b>(Convergence criteria)</b>	<b>Criteria</b>						
1.CPI (annual average)	-0.5%(note)	4.0	7.9	6.2	4.0	3.5	3.0
2.10 year government bond yield	4.8%(note)	7.1	6.7	8.3.	n.a.	n.a.	n.a.
3.General gov't fiscal balance/GDP(ESA95)	Below -3%	-9.2	-5.0	-3.4	-3.9	-4.8	-3.5
4.General gov't debt/GDP(ESA95)	Below 60%	65.6	65.8	72.0	79.0	82.5	82.0
Real GDP growth rate	(%)	4.0	1.2	0.6	-6.3	-0.2	3.0
Unemployment rate (annual average)	(%)	7.5	7.3	7.9	10.1	11.0	10.0
Current account balance/ GDP	(%)	-7.7	-6.8	-7.2	0.5	-1.1	-2.7
Trade balance/ GDP	(%)	-2.3	0.2	-0.1	4.7	3.6	2.6
Net Foreign Direct Investment/ GDP	(%)	3.1	1.6	2.4	0.2	0.8	0.9
Forex reserves (excl. gold)	(EUR mln)	15,841	15,804	26,725	28,527	31,200	30,500
Forex reserves / monthly Imports (G&S)	(months)	2.7	2.4	3.7	5.2	5.3	4.6
Forex reserves/ short-tem external debt	(times)	1.4	1.0	1.4	1.4	1.5	1.4
External debt/ GDP	(%)	90.9	98.4	115.4	139.2	142.1	133.7
External debt/ exports (G&S)	(%)	118.2	123.2	141.0	180.6	181.3	169.3
Public external debt/ exports (G&S)	(%)	44.5	42.9	45.7	67.2	69.2	60.0
Debt service ratio	(%)	29.4	26.0	23.2	35.0	31.9	27.6

(Note) Figures for criteria 1 and 2 are average ratio of 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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