

## Hungary (the Republic of)

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

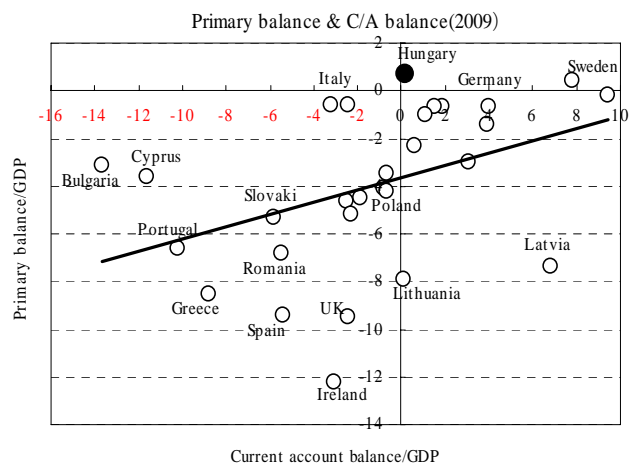
### <Rating Perspective>

#### Positive Factors

- Improved external liquidity position mainly 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 March to June, 2010>

#### Positive Factors

- New Prime Minister Viktor Orban pledged to stick to the deficit target of 3.8% of GDP in 2010, approved by the IMF and the EU. The plan includes spending cuts of 1.0% -1.5% of GDP to achieve the target (6/12)
- The center-right Fidesz-Hungarian Civic Union (Fidesz) won sweeping victory with more than a two-thirds majority in parliamentary elections held on April 12 and 25. On May 25, new administration led by Prime Minister Orban was formed
- The current account balance in 2009 turned into a marginal surplus to 0.2% of GDP stemming from substantial trade surplus
- In spite of widened general government fiscal deficit (ESA95) in 2009 to 4.0% of GDP from 3.8% in 2008, primary balance remained surplus at 0.7% of GDP
- The IMF's fifth review under the Stand-By Arrangement was officially approved on March 26, 2010.
- The real GDP(SA) in the January to March quarter of 2010 surged to 0.9% quarter-on-quarter, a two consecutive QOQ growth
- Foreign exchange reserve at the end of May 2010 swelled to EUR 34.9 billion, equivalent to 1.7 times of the short-term foreign debt at the end of 2009

#### Negative Factors

- Negative comments made by a ruling Fidesz party's main politician that *Hungary had only a slim chance of avoiding a Greek-style scenario and Hungary is next to default* on June 3, 2010 caused temporary turmoil on capital market
- The central government fiscal balance in the first four months of 2010 widened slightly to 2.4% of GDP from 2.0% a year before

### <Outlook and Points to Watch>

#### Cautious policy may be pursued by new government

##### (1) Government response to the negative comments made by a ruling party's main politician

Hungary's new government has affirmed the fiscal deficit target of 3.8% of GDP for this year as previous government agreed with the IMF and the EU, in response to the market turmoil ignited from the comments made by a ruling Fidesz party's main politician that *Hungary had only a slim chance of avoiding a Greek-style scenario and Hungary is next to default* on June 3. The intentions of the comment hardly know, but were mainly initiated by showing Fidesz's constituency the current state of public finance. During the election campaign, Fidesz hinted to put more stress on fostering economic growth rather than fixing budget deficit.

Then major opposition party Fidesz won sweeping victory with a two-thirds majority in April election. New Prime Minister Orban unveiled a pro-growth strategy such as tax cut, reducing red tape and an increase in employment. However, in the wake of above-mentioned comments and subsequent market turmoil, Prime Minister unveiled an

economic action plan (the action plan of 29 points) aimed at containing the budget deficit to 3.8% of GDP in line with previous agreements with the IMF and the EU on June 8. On the revenue side, the tax on financial institutions, elimination of the practice to exempt the minimum wage from taxation, and the introduction of a single-rate (16%) tax system are the most important changes. Major expenditure reforms include reduction of the posts in supervisory and managing boards of state companies, and a limit of wages and purchases of governmental organs and state enterprises. Also on June 11, Prime Minister expressed his intention to disclose the second economic action plan this fall. The more detailed plan has not disclosed yet, but this commitment indicates the reversal to more cautious fiscal policy.

## (2) JCR does not consider that this event immediately necessitates rating action

On March 5 2010, JCR has affirmed its ratings and revised their outlook from negative to stable. 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 former 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. JCR assumes that the 2010 deficit may widen moderately, but that the government will keep the 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. Since the ongoing development is in line with our assumption, immediate rating action is unnecessary.

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

JCR considers that immediate liquidity problem is highly unlikely. The economy, though contracted 6.3% in 2009, started improving from the April-June quarter of 2009 and is highly likely to settle with a marginal contraction in 2010. Hungary is one of a few EU countries that run the primary balance surplus (0.7% of GDP) in 2009. The current account balance also turned into a marginal surplus (0.2% of GDP) in 2009 and keep growing in 2010. The foreign exchange reserves swelled to EUR 34.9 billion at the end of May 2010, which was 1.7 times as much as the short-term foreign debt at the end of 2009. The government also has significant amount of deposits and undrawn facility from the IMF loan.

Nonetheless, the country's debt burden remains heavy as the external debt standing at EUR130.3 billion at the end of 2009 or around 130% of GDP and the ratio of the general government fiscal debt to GDP surged to nearly 80% at the end of 2009. Hungary remains vulnerable to the effect of financial market. Therefore, JCR continues to watch carefully the country's future repayment and the detail of the economic action plan.

## (4) Sweeping victory of Fidesz in the parliamentary election

In the first and second round of the April elections, Fidesz won the absolute majority of parliamentary seats, enough power to modify major laws and the country's constitution. The poll shows that Fidesz won 263 of total 386 seats. The former ruling *Hungarian Socialist Party* was the second-largest party with 59 seats, but defeat seriously. The far-right and nationalists party *Jobbik* won 47 seats, benefiting dissatisfaction of austerity measures in the recent years and prolonged economic recession. The green party, *Politics Can Be Different* secured the fourth position with 16 seats.

### Main Economic Indicators: The Republic of Hungary

		2006	2007	2008	2009	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	4.5	3.5
2.10 year government bond yield	4.8%(note)	7.1	6.7	8.3.	9.1	n.a.	n.a.
3.General gov't fiscal balance/GDP(ESA95)	Below -3%	-9.2	-5.0	-3.4	-4.0	-4.0	-3.5
4.General gov't debt/GDP(ESA95)	Below 60%	65.6	65.9	72.9	78.3	79.5	80.3
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	0.2	-1.2	-2.8
Trade balance/ GDP	(%)	-2.3	0.2	-0.1	4.3	3.2	2.2
Net Foreign Direct Investment/ GDP	(%)	3.1	1.6	2.4	-1.4	0.8	1.0
Forex reserves (excl. gold)	(EUR mln)	15,841	15,804	26,725	28,527	33,500	35,500
Forex reserves / monthly Imports (G&S)	(months)	2.7	2.4	3.7	5.2	5.7	5.3
Forex reserves/ short-tem external debt	(times)	1.4	1.0	1.4	1.4	1.6	1.6
External debt/ GDP	(%)	90.9	98.4	115.4	140.1	136.4	131.3
External debt/ exports (G&S)	(%)	118.2	123.2	141.0	181.4	178.5	168.3
Public external debt/ exports (G&S)	(%)	44.5	42.9	45.7	65.5	68.1	59.7
Debt service ratio	(%)	29.4	26.0	23.2	34.8	31.7	27.5

(Note) Figures for criteria 1 and 2 are average ratio of 2009. Figures for 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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