

Hungary (the Republic of)

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

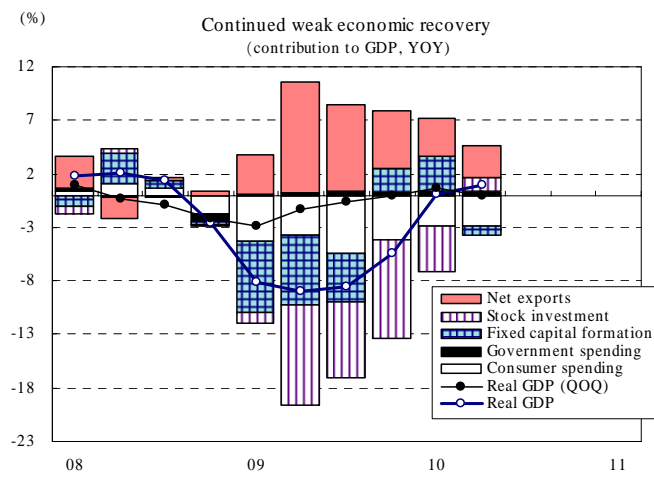
<Rating Perspective>

Positive Factors

- Improved external liquidity position mainly supported by the IMF loan package
- 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 June to September 2010>

Positive Factors

- On September 10, the government announced its commitment to rein the general government fiscal deficit to below 3% of GDP in 2011
- Trade surplus in the first half of 2010 widened to 2.9% of GDP from 1.9% a year earlier
- The real GDP (seasonally adjusted) in the April to June quarter of 2010 kept flat from the previous quarter on the surge in exports in spite of the continued sluggish domestic demand. Industrial output in the April to June quarter of 2010 expanded sharply to 12.7% year-on-year on the robust exports
- The unemployment rate in July 2010 was 10.3%, a decline for three consecutive months from May 2010
- Foreign exchange reserve at the end of August 2010 swelled to EUR 35.3 billion, equivalent to 1.6 times of the short-term foreign debt at the end of March 2010 or 6.1 times of monthly imports in the first half of 2010
- Consumer price inflation in August 2010 declined to 3.7%, due mainly to subdued impacts of the tax hikes in the previous year

Negative Factors

- The sixth and seventh reviews of the Stand-By Arrangement between the IMF/EU and the Hungarian government was suspended on July 17
- The central government fiscal balance in the first six months of 2010 widened slightly to 3.8% of GDP from 2.7% a year before
- External debt held by the government at the end of March 2010 increased by 21% to EUR 50.8 billion or 51.3% of GDP from EUR 42 billion a year before

<Outlook and Points to Watch>

Focusing on the renegotiation with IMF in October

(1) Suspension of negotiation of the Stand-By Arrangement with IMF/EU

The sixth and seventh negotiation of the Stand-By Arrangement between the IMF/EU and Hungary's new government led by Fidesz which took office in April 2010 after sweeping victory in the April election fell into suspension on July 17. As the IMF made comments "While there is much common ground, a range of issues remain open", major disagreements seems to be the proposed heavy levy on the financial sector, which could harm the country's future economic prospect, and additional fiscal consolidation measures expected to be introduced to keep the fiscal deficit at 3.8% of GDP in 2010 and at below 3.0% in 2011.

JCR considers that this event could put negative impact on the ratings. The extension of the Stand-By

Arrangement with IMF/EU, which will be expired in October 2010, is critical for Hungary. The country's fund procurement remains vulnerable to the effect of financial market because of its heavy debt burden. Nonetheless, it is rather premature to evaluate the economic and fiscal policies of this five months old government, and before the local election scheduled in early October. JCR will monitor the development of the renegotiation with the IMF/EU sometime in October, and reflect thereby revelations of the new government's policy stance into the ratings.

(2) Economic recovery remained weak on the sluggish domestic demand

The Hungarian economy in 2009 contracted 6.3%, 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 economic contraction has been easing gradually (quarter-on-quarter) from the April-June quarter of 2009 reflecting a sharp increase in exports. The economy turned around to a positive growth from the October-December quarter of 2009 to the April-June quarter of 2010. Nonetheless, the recovery remained weak on the sluggish domestic demand. It is highly likely that the economy is projected to grow only marginally in 2010 and gain greater strength in 2011. Meanwhile, the consumer price inflation jumped to around 5% year-on-year in July 2009 following increases in the VAT and excise taxes, but stabilized to 3.7% year-on-year due mainly to subdued impacts of the tax hikes. National Bank of Hungary has cut its interest rate by a total 625 bps since November 2008. The rate currently stands at 5.25%. 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. The effect derived from rising credit costs and heavy levy on the financial sector should be monitored.

(3) 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 have been a strong policy anchor of the fiscal and economic policies of the government. It also helped improve international investors' confidence on Hungary and the country's external liquidity position. 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 to 0.2% of GDP in 2009. The current account balance in the first three months of 2010 continued to produce a surplus. Furthermore, trade balance statistics in the first six months of 2010, which had already published, showed that the balance surged to 2.9% of GDP from 1.9% a year earlier. The foreign exchange reserves renewed its record to EUR 35.3 billion at the end of August, 2010, which was 1.6 times as much as the short-term foreign debt at the end of March 2010 and 6.1 times as much as the average monthly imports in the first six months of 2010. However, the county's external debt burden remains heavy with the foreign debt standing at EUR 135.5 billion (137% of GDP) at the end of March 2010.

Main Economic Indicators: The Republic of Hungary

		2006	2007	2008	2009	2010 (f)	2011 (f)
(Convergence criteria)	Criteria						
1.CPI (annual average)	-0.3%(note)	4.0	7.9	6.2	4.2	3.5	3.0
2.10 year government bond yield	4.6%(note)	7.1	6.7	8.3	9.1	n.a.	n.a.
3.General gov't fiscal balance/GDP(ESA95)	Below -3%	-9.3	-5.0	-3.8	-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	2.5
Unemployment rate (annual average)	(%)	7.5	7.4	7.8	10.0	10.2	9.8
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	6.1	5.6
Forex reserves/ short-tem external debt	(times)	1.4	1.0	1.4	1.4	1.7	1.7
External debt/ GDP	(%)	90.9	98.4	115.4	140.5	137.2	133.4
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 between August 2009 and July 2010. 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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