

Hungary (the Republic of)

Foreign LT: A/Stable, Local LT: A+/Stable (Latest rating review released on March 22, 2004)

Main Factors for the Ratings

Positive Factors

- With the adoption of the euro in sight, more stable economic structure will be established.
- Stronger economic ties with EU since the early stage of its economic transformation.
- Rising exports resulting from the expansion of production capacity and sophistication of industrial structure through inflows of FDI.

Negative Factors

- Growing government debt due to persistent budget deficits.
- A wage increase higher than productivity growth eroding the competitive edge.

Updated: from February 2004 to April 2004

Positive Factors

- On May 1, 10 countries including Hungary joined the EU.
- The government approved a spending cut plan totaling Ft155 billion or 0.8% of GDP.

the government's fiscal deficit in the first four months of 2004 (excluding local governments) was Ft547.0 billion, or 0.95999% of GDP.

<Prospects and Noticeable Points>

Signs of improvement toward sustainable economic expansion

Real GDP grew by 3.6% year-on-year in the October-December quarter of 2003, up from 2.9% in the previous quarter. The economy continued to expand at an unsustainable pace led mainly by very strong consumer spending. However, the economy showed signs of improvement toward sustainable growth in the October-December quarter. While the growth of consumer spending slowed down to 4.4% year-on-year, both gross capital formation and exports gained strength to grow by 4.7% and 17% year-on-year, respectively. Meanwhile, consumer price index was on the upward trend, reflecting the depreciation of the forint and a surge in food and energy prices. In April, CPI rose as much as 6.9% mirroring the additional upward pressure caused by the implementation of a tax increase in January. The central bank lowered its key policy rate by 50bps on May

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4, following the two identical cuts of 25bps on March 22 and April 6, in consideration of the favorable economic and financial developments.

The current account deficit in 2003 widened to the level equivalent to 8.9% of GDP from 7.1% in 2002. Due to statistical revisions, such as the inclusion of reinvestment earnings in accordance with the EU standards, the income balance deficit deteriorated by EUR2.5 billion or 3.4% of GDP in 2003 as compared with that based on old statistics. As far as figures for the first three months of this year are concerned, the current account deficit widened by 18% from the year earlier, due mainly to deteriorating deficit in the services balance, but the trade deficit tended to improve gradually.

Signs of improvement in fiscal deficit

The government approved a spending cut plan totaling Ft155 billion or 0.8% of GDP. Through the implementation of the plan, the government estimates that the general government deficit (ESA95) will be narrowed to 4.6% of GDP in 2004 from 5.9% in 2003. According to quarterly estimates for 2004 bared by the government, the fiscal deficit (excluding those of local governments) will start shrinking in the third quarter after a continued rise in the second quarter. The fiscal deficit for the first quarter turned out to be slightly larger than the government projection, but the deficit for the first four months of 2004 was smaller than estimated due mainly to an increase in VAT revenue. JCR believes that the ratio of fiscal deficit to GDP in 2004 will be higher than 5%, but it will fall below the previous year's level, provided that the spending cut plan is steadily implemented.

Further spending cut is needed to ensure fiscal improvement

Following the entry into the EU on May 1, 2004, one of factors that will affect the rating on Hungary would be how soon it will adopt the euro. The government revised its euro adoption date from 2008 2010 on May 13, 2004. The new adoption plan envisages that by the end of 2008, convergence requirements will be met. JCR holds a view that the government will make a continuous effort to achieve convergence requirements, because significant delay of the euro adoption date has been avoided. In order to achieve requirements, the most critical issue for Hungary is to curb its fiscal deficit and government debt. If the spending cut plan were implemented as planned, it is highly likely that the fiscal deficit will gradually improve. However, the government will be required to step up further spending cuts to provide room for expenditures needed for infrastructure investment related to the EU entry. With the next general election expected in 2006, there remains the possibility that expenditure pressure will gather momentum in 2005, given the declining popularity of the ruling Socialist Party. JCR has retained its current ratings but it may consider revising its rating outlook should the government fail to carry out spending cuts in 2004.

Main Economic Indicators: The Republic of Hungary

		2000	2001	2002	2003	2004(f)
(4 Convergence criteria)						
1.CPI (annual average)	(%)	9.8	9.2	5.3	4.7	6.5
2.10 year government bond yield	(%)	8.0	7.1	6.4	8.0	9.0
3.General gov't budget deficit/GDP(ESA95)	(%)	-3.0	-4.4	-9.3	-5.9	-5.5
4.General gov't debt/GDP(ESA95)	(%)	55.4	53.5	57.1	59.0	60.6
Real GDP growth rate	(%)	5.7	3.8	3.3	7.9	3.5
Unemployment rate (year-end)	(%)	6.4	5.7	5.8	5.9	5.8
Current account balance	(Euro mn)	-4,380	-3,613	-4,900	-6,488	-5,950
Current account balance/GDP	(%)	-8.6	-6.2	-7.1	-8.9	-7.5
Foreign Direct Investment	(Euro mn)	1,199	2,513	824	-1,228	500
Foreign Direct Investment/GDP	(%)	2.4	4.3	1.2	-1.7	0.6
Forex reserves (excl. gold)	(Euro mn)	12,038	12,163	9,887	10,108	10,000
Imports (G&S) coverage	(months)	3.7	3.4	2.6	2.5	2.3
External debt/ GDP	(%)	64.9	65.6	56.6	62.4	64.1
External debt/ exports (G&S)	(%)	87.9	90.0	88.5	101.1	105.3
Public external debt/exports (G&S)	(%)	48.4	46.1	48.7	50.3	50.4

Note: figures for 2004 are based on JCR forecast.

Sources: European commission, Central bank, and Ministry of Finance.

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