

Hungary

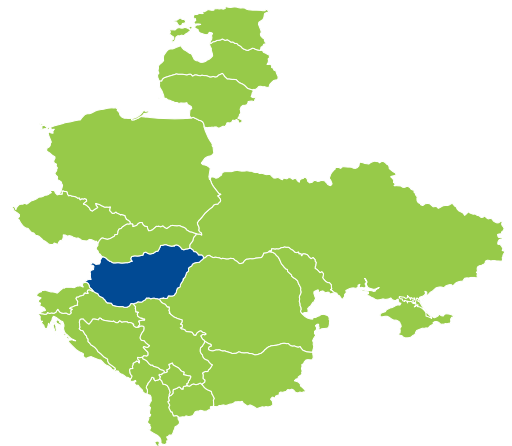


The need to respond vigorously to the global economic crisis with heightened levels of fiscal discipline resulted in further falls in the popularity of Hungary's ruling parties. This led to the resignation at the end of March 2009 of Prime Minister Ferenc Gyurcsany, whose popular standing had already been relatively low for some time before the eruption of the financial crisis. His successor, Gordon Bajnai, enjoying majority support in the parliament from the Hungarian Socialist Party and the Free Democrats, has received the approval of investors for signs that his government is committed to cutting public spending, increasing revenues and improving the efficiency of the tax regime. Results in the EU elections just two months after his installation as prime minister, however, suggested that his fiscal toughness was already affecting his popularity with the public, as right wing parties made major advances at the Socialists' expense.

Hungary has a declining and ageing population, which is embroiled in tensions affecting the integration of its Roma community. This is the largest of its ethnic minorities and tensions between Romas and non-Romas have in recent months erupted into a growing number of violent atrocities stirring racist sentiment. In parallel with the need to address this situation, Hungary is also seeking to grow the proportion of economically active people within its population, which stands around 50% of labour force (the lowest rate among all Central European countries).

The working population is continuing to shrink, with a 1.2% decrease in the number of employed during 2008 alone contributing to a growing unemployment rate that, at 8%, is at its highest since 1998.

In addition, Hungary faces an overall environment of shrinking GDP. This was reported to have fallen by 2.5% in 2008, although when the still burgeoning agricultural sector is excluded the reduction declines sharply to some 4%. The country also faces an exceptionally high level of indebtedness which, at over 70% of GDP (expected to grow to 80% in 2009), is already the highest in the CE region. Such levels of debt led several commentators to believe that Hungary was on the edge of bankruptcy in the autumn of 2008, resulting in a major flight of capital



away from the country as investors sought to reduce their exposure to perceived risk.

These significant trends combined to threaten the Hungarian government's ability to finance its debt servicing commitments in late 2008, leading in turn to a dramatic fall in the Forint's exchange rate against the Euro and other major western currencies. In order to calm investors' nerves and prevent further acceleration in the exodus of capital, the government and national bank sought and received a EUR 20 billion credit line facility from the IMF and the EU in November 2008.



While this did have the desired effect of enabling the Hungarian financial sector to achieve some stability during a period of almost unprecedented turmoil, a precondition of the agreement was that the government should introduce strong measures to curb its spending and stabilise the budget deficit.

Although it is widely expected that the country's indebtedness will continue to climb during the remaining months of 2009, these actions are likely to have some rapid positive effects on the Hungarian economy. Some have already been witnessed – for example, the improved investor confidence that they have enabled has led to an improvement in the Forint's exchange rate, which

recovered by the end of July to below 270 against the Euro from a low of 317.

The budget deficit, meanwhile, is forecast to be just 3% in 2009 and 2010, while the cost of servicing foreign debt is expected to represent some 13% of export values. This is around half the proportion experienced in Poland, for example.

The global financial crisis and exodus of capital from Hungary resulted during the last three months of 2008 in a EUR 0.7 billion reduction in banks' debt provisions in the country. This particularly affected short-term credit facilities, but the availability of long-term loans for businesses was also significantly reduced. While this is unsurprising within the context of the banking industry's global crisis, it is also a contributory factor to the industry's widely expected losses for 2009 that are also being driven by higher costs of financing and increased exposure to bad debts.

The Hungarian economy is strongly export-driven, a characteristic it shares with many other CE states that have recently joined the EU. This is the result of the investments made in the country by major multinational companies, including Suzuki, Audi, General Motors, General Electric, Nokia and others. While this has been a cause of growing economic strength in recent years, in 2008 it hastened the impact of recession on the country. The global drop in demand for goods – with the automotive and electronic manufacturing sectors being particularly hard hit – was initially damaging. This was quickly exacerbated by the speed and efficiency with which the affected companies responded by implementing major redundancy rounds.

Despite the still gloomy global business environment, the strong measures introduced by the government to curb its spending and stabilise the budget deficit have been positively received by international credit rating institutions. If the government manages to execute its crisis managing plans vigorously, does not fall into the trap of going for an "election budget", and makes the best use of available EU funds, Hungary has the opportunity to emerge from the crisis stronger than before the downturn.

Hungary	2005/2007 Average Values	2007-2008	2008
	Change (%)	Change (%)	
Population (mil.)	-0.3	-0.3	9.9
Average monthly gross wage (EUR)	8.3	0.2	836.1
EUR Exchange rate vis-à-vis	1.0	4.2	263.6
USD Exchange rate vis-à-vis	-0.5	9.0	188.3
	Real change (%)	Real change (%)	EUR mil.
GDP	3.0	-2.5	101,006
Private consumption	1.9	-0.5	52,718
Public consumption	0.2	-1.9	9,577
Gross fixed capital investments	1.3	-2.6	20,331
Exports (goods and services)	15.4	4.8	82,270
Imports (goods and services)	11.7	4.7	81,031
	Nominal change (EUR mil.)	Nominal change (EUR mil.)	EUR mil.
Trade balance	944	279	-903
Current account balance	224	-1,895	-8,449
General government balance	-274	2,612	-3,441
General government gross debt	5,424	7,429	73,734
External debt	3,332	4,941	38,355
Foreign currency reserves	1,526	7,756	23,560
	Percentage point change	Percentage point change	%
Economic activity rate	0.3	-0.4	50.1
Unemployment rate	0.5	0.3	8.0
CPI rate (previous year = 100%)	0.6	-3.9	3.5
Central bank interest rate	-0.7	2.5	10.0
1-year yield on Treasury Bill	-0.4	1.5	9.1
10-year yield on Treasury Bond	0.0	1.2	8.4

Sources used: Reuters EcoWin Pro

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