MINISTRY
FOR NATIONAL ECONOMY

UPDATE

on

THE 2012 BUDGET OF HUNGARY

SZÉLL KÁLMÁN PLAN

September 2011

The Hungarian government is firmly committed to uphold the deficit target of 2.5% of GDP as set in the Széll Kálmán Plan and the Convergence Programme even in the volatile global economic environment and the turbulences caused by the European sovereign debt crisis. To this end, the Government announced new measures to improve the budget by 1000bn HUF in 2012, including a buffer for unforeseen negative developments.

Since the announcement of the Széll Kálmán Plan, the global and domestic economic environment has changed significantly in the following aspects:

- Risks to growth have become graver. The growth of our key foreign trading partners is expected to slow down substantially,
- Financial risks have become more pronounced. The uncertainty in global financial markets needs to be monitored more closely,
- One positive development is that Hungary, as one of the very few countries in Europe, achieved that the interest payments on public debt have declined following the reduction of public debt.

Consequently, in light of the new circumstances, the Government decided to revise its macroeconomic forecast and, in order to achieve its ultimate objective, to implement the necessary measures.

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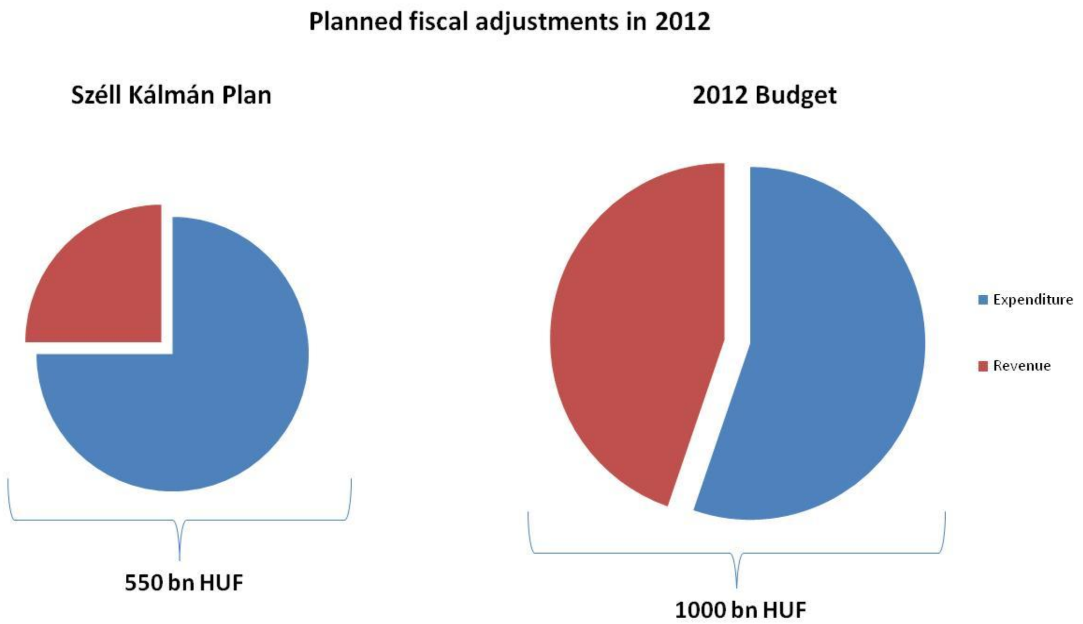
A new macro outlook

The revised macroeconomic forecast which serves as a basis for the calculations of the 2012 Budget includes the impact of the new measures, and displays weaker growth prospects. These, however, are mainly driven by external factors.

- The growth rate goal of the government for 2012 remains 2%, in line with market expectations. However, having considered the prevailing risk factors as well as the impact of new measures, we assume a GDP growth of 1.5% for the 2012 budget calculations.
- We project a 4,2% CPI inflation for 2012, which signals a slight rise.
- We will pursue a deficit target of 2.5% of GDP which facilitates a further reduction of public debt, down from 73,2% at the end of this year to 72% till the end of 2012
- Due to the measures aimed at reducing the level of public debt and the ensuing improving financing conditions, the interest payments for public debt continue to decrease further to 3.6% of GDP from the current 3.8%.
- Household consumption growth is expected to remain positive in 2012 by 0.2%.
- After the 2% decrease in investments this year, next year we expect investments to rise by 3.2%.
- Our external position will remain strongly positive: we expect both the foreign trade balance and the current account to be bold in surplus next year.
- Labour market conditions are expected to improve further: payroll numbers will rise by 1.5% and the employment rate by 1 percentage point, whereas the unemployment rate will continue to decline steadily, to levels below 11%.

The Budget of 2012

Even as circumstances have changed, the government is committed to uphold the deficit target of 2.5% as of GDP, which will place Hungary among the most stable economies of Europe. In order to achieve this, improvements in the budget balance totaling 550bn HUF based on the economic environment characteristic of period as the Széll Kálmán Plan was announced. On the basis of recent developments, however, we need further measures to improve the balance by 1000bn HUF. The majority of these measures will be achieved by the reduction of expenditures.



The projected improvement of the balance is the result of the following items:

- as far as expenditures are concerned, the Stability Fund of 250bn HUF, which was put in place after the announcement of (and therefore not included in) the Széll Kálmán Plan, will be added to the Budget base and contribute to a structural improvement;
- we will reduce expenditures by 303bn HUF;
- and the headline figure for total revenues will be raised by 445bn HUF due to changes in taxes and other revenue side measures.

Compared to 2011, the 2012 balance will improve by additional 750bn HUF, in top of the Stability Fund which has been included in the base calculations for 2011. The amount of 750bn HUF is made up by two main items: an improvement of the budget balance by 600bn HUF on the one hand, and a new Financial Protection Fund of 150bn HUF that provide a buffer in order to secure the targets in case of less favourable scenarios. This fund will be financed by higher VAT rates. A higher safety margin will be provided by the radical reduction of public debt, and the interest payments will decrease by 50bn HUF, a figure which had not been included in the preliminary calculations. This amount, however, will remain a buffer to address unforeseen future events.

It should be underlined that the government remains fully committed to pursue the projected course of the Budget which will make Hungary one of the most fiscally predictable countries and thus secure the gradual reduction of public debt.

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