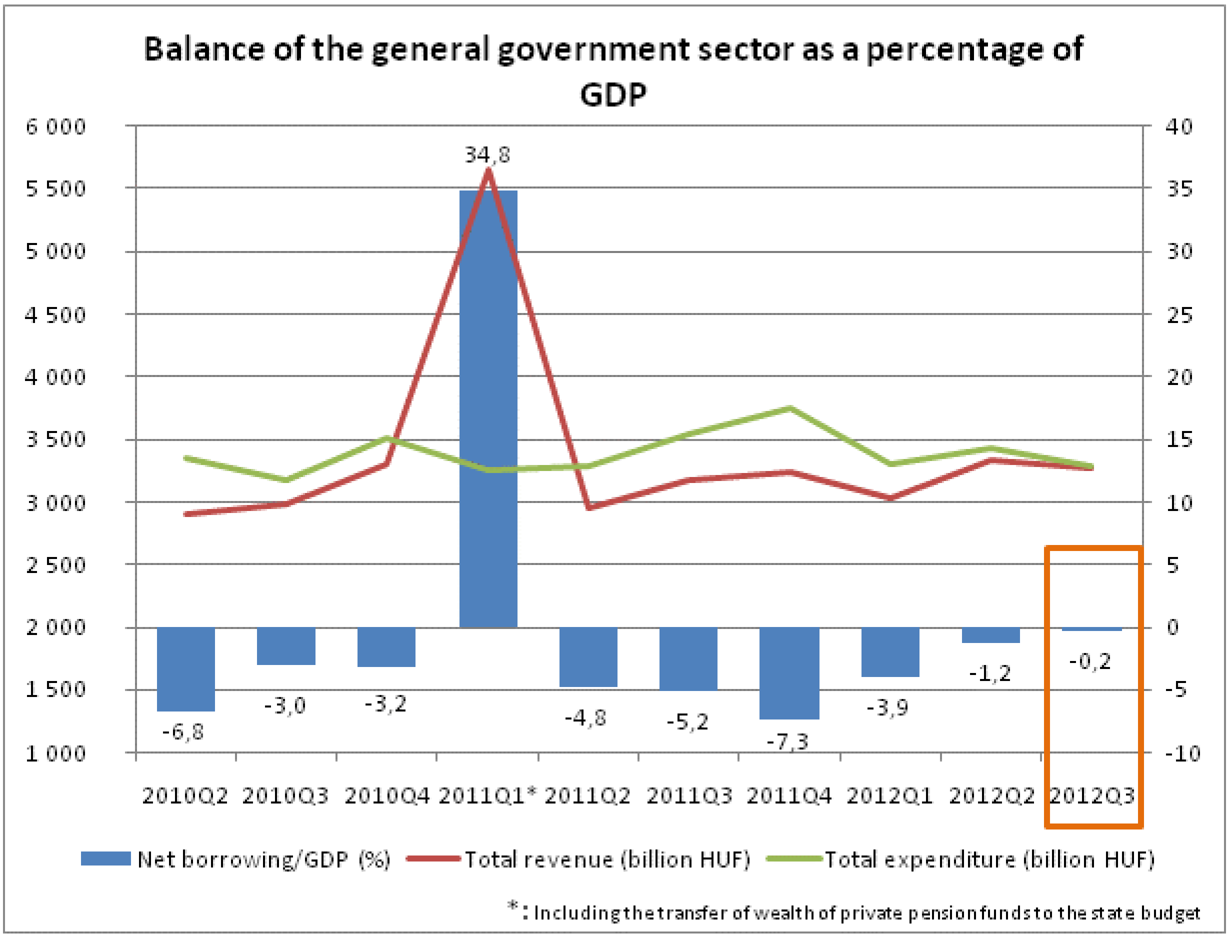
Favourable fiscal processes

In 2012 – according to preliminary cash flow data – it is almost certain that the deficit target of 2.7 percent assumed for 2012 and calculated by EU methodology will be achieved. The accrual-based ESA95 deficit published recently by the Hungarian Central Statistical Office (KSH) also confirms this assumption. On the basis of data it can be concluded that the government sector deficit as a percentage of GDP was the lowest in Q3 2012 since Q1 1999[1] and it is 5 percentage points lower compared to the figure of the corresponding period of 2011. The significant decrease of expenditures and the moderate increase of revenues have both contributed to this favourable achievement. As far as the initial three quarters of 2012 are concerned, fiscal figures are similarly impressive. Investors appreciated the improving trend signalled by fiscal indicators, as yields on benchmark Hungarian government securities have declined substantially in 2012.

For the year of 2012 preliminary data signal a cash glow deficit of 607.5bn HUF for the central sub sector of the state budget, amounting to 2.1 percent of GDP, instead of the formerly amended figure of 671.9bn HUF. **According to preliminary data, the 2.7 percent deficit target assumed for 2012 and calculated by EU methodology is almost certain to be reached.**

The central sub sector of the state budget in December 2012 registered a cash flow surplus of 84.2bn HUF, which was the consequence of the 119.4bn HUF surplus of the central government budget and the deficits of 33.2bn HUF and almost 2.0bn HUF, respectively, of Social Security Funds and Extra-budgetary Funds.

[1] Excluding the surplus in Q1 2011 which resulted from the private pension fund asset transfer to the state.

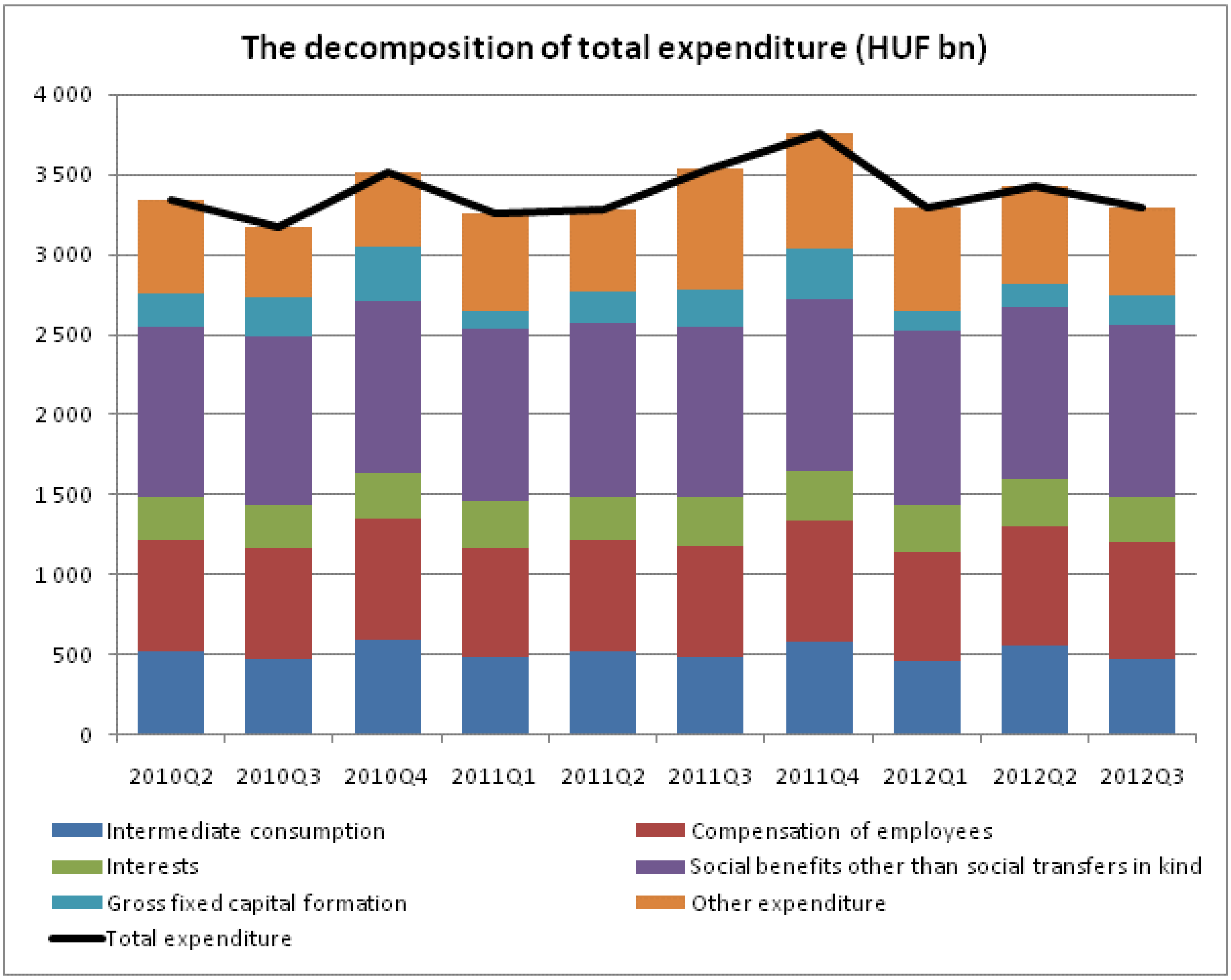


Source: Hungarian Central Statistical Office

Data of the first three quarters calculated by EU methodology

On the basis of the publication titled *Revenue and expenditure data of the government sector* released on 3 January 2013 by the Hungarian Central Statistical Office (KSH), in the initial three quarters of 2012 – in line with the methodological requirements for the system of national accounts (ESA95) – the deficit of the general government sector reached 1.8 percent (375bn HUF) of GDP which is 3.1 percentage points lower compared to the figure of the corresponding period of the previous year, adjusted for receipts from private pension fund assets.

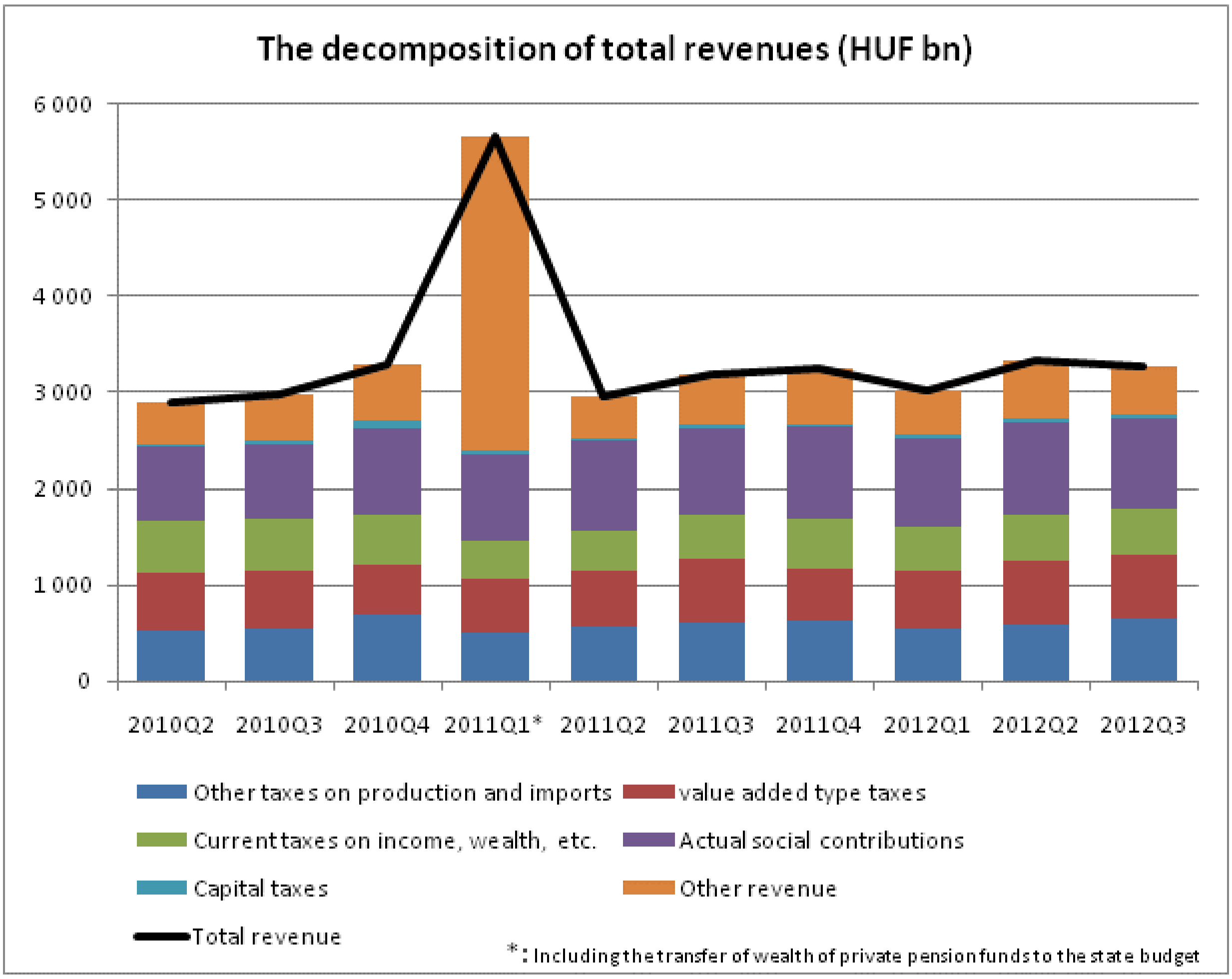
On the other hand, in the third quarter of 2012 central government budget was practically balanced; statistics showed a minimal deficit of 0.2 percent (17.3bn HUF) which has been the lowest figure since Q1 1999. This figure corresponds to a fiscal improvement of 5 percentage points of GDP compared to the third quarter of 2011.



Source: Hungarian Central Statistical Office

Total nominal expenditures decreased by 0.7 percent in the initial three quarters of 2012 compared to Q3 2011. The reason for this has been the 13.8 percent decrease of gross fixed capital formation and the similar decline of social transfers in kind purchased by the Government along with the 3.1 percent rise in the compensation of employees and the increase of 1.7 percent and 1.3 percent, respectively, of interest expenditures and intermediate consumption.

The 7 percent year-on-year decline of expenditures in Q3 2012, however, originated from the 20.9 percent, 6.6 percent and 1.9 percent decline, respectively, of gross fixed capital formation, interest expenditures and intermediate consumption on the one hand and the 5.2 percent increase of employee compensation on the other.



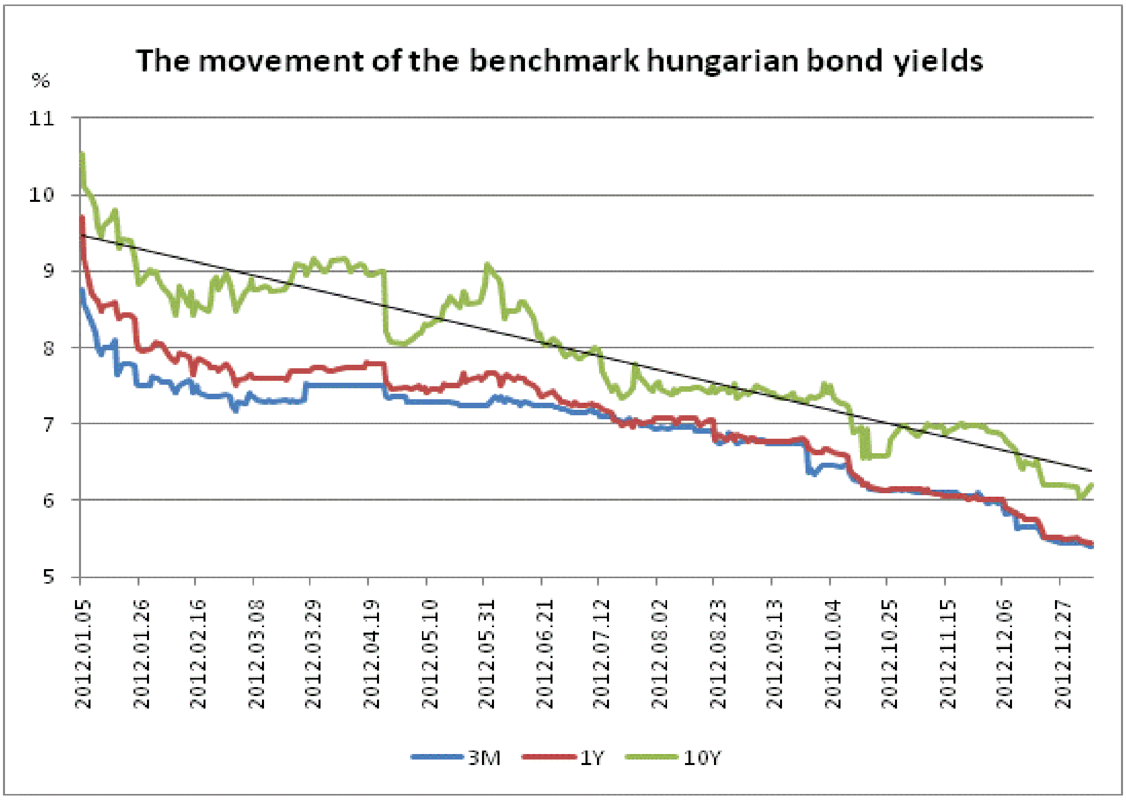
Source: Hungarian Central Statistical Office

In the initial three quarters of 2012 total revenues were 6.3 percent higher on a year-to year basis calculated by excluding private pension fund transactions. In light of statistics revenues increased in each category, but the largest contributor to overall revenue increase was the 12.2 percent rise in personal income tax receipts due to the abolition of tax credits.

In the third quarter of 2012 the increase of income tax revenues (11.1 percent) was the key reason for the 3.1 percent year-on-year rise of total revenues, but the 4.1 percent and 2.1 percent increase, respectively, of social security contributions and taxes on production has also positively contributed to total revenue growth.

Favourable market trends

The favourable change in the general government deficit-to-GDP ratio has also been welcomed by investors and it is aptly reflected, among others, in the risk perception indicators of Hungarian government debt. Yields of benchmark government securities on the secondary market decreased quite substantially which had been due, besides external market developments, to the favourable change in fiscal indicators. **Yields on 10-year securities declined to the largest extent compared to level at the beginning of the year, from the former 10 percent (a sudden peak at that time) to 6 percent,** but yields on 3-month and 12-month securities have also declined sharply, by about 330-350 basis points.



Source: Reuters