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## UPDATE

on

# THE STATE OF THE HUNGARIAN ECONOMY

SZÉLL KÁLMÁN PLAN

September 2011

In Hungary the new government, which has been in office for 15 months, implemented several key measures, and the early preliminary positive signs of the prudent and sound economic policy is visible in the macro trends. The **key reasons** of this are the following:

- **Tax-cutting measures of the government** actually amounted to 600bn HUF without taking into account the impact of favourable macro-economic trends (PIT top tax rate was reduced and tax credits were tightened - 330 bn, - new system of family tax credits were implemented - 145 bn, the government cut the tax burden of SMEs - 110 bn)
- The key objective of the **budget reform programme** is to consolidate the budget of Hungary, boost employment and increase the competitiveness of the Hungarian economy. The government will cut the budget deficit to 2.5% in 2012, 2.2% by 2013 and 1.9% by 2014.
- In Hungary, **administrative burdens** amount to 3000bn HUF or 10.5% of GDP, while the EU average is 1000bn HUF or 3.8% of GDP. The first programme of the government aimed at cutting red tape reduces the burden of Hungarian enterprises by 500bn HUF.

## Flash report on the Hungarian economy in the middle of 2011

### GDP growth

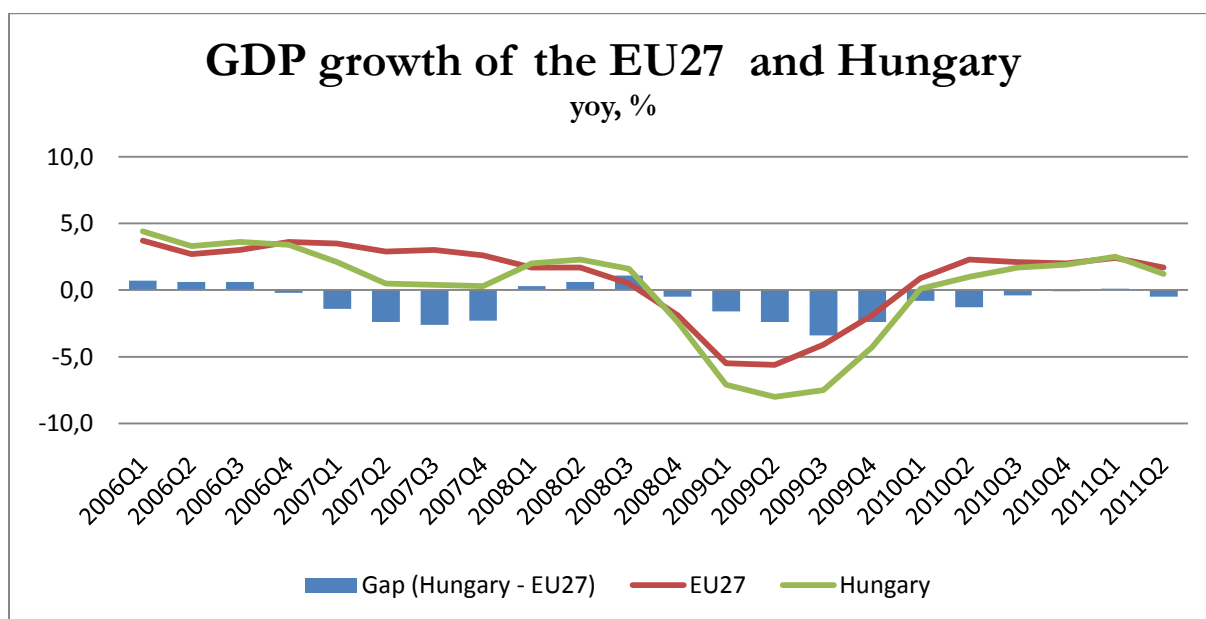
In an unfavourable global economic environment the **Hungarian growth factors can also get jeopardized**. The growth target set by the government may also need a revision in the light of the global slowdown. According to the first flash estimate, the Hungarian economy grew by 1.5% in the second quarter. This figure is lower than the 2% which had been anticipated and it is a



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result of base effect on the one hand and the weaker than expected performance of the export-oriented industrial sector on the other.

However, it has been a favourable development that Hungary could achieve growth close to the EU average during the last four quarters, therefore the **widening of the gap with EU indicators has come to a halt or at least has been reduced to a minimum.**



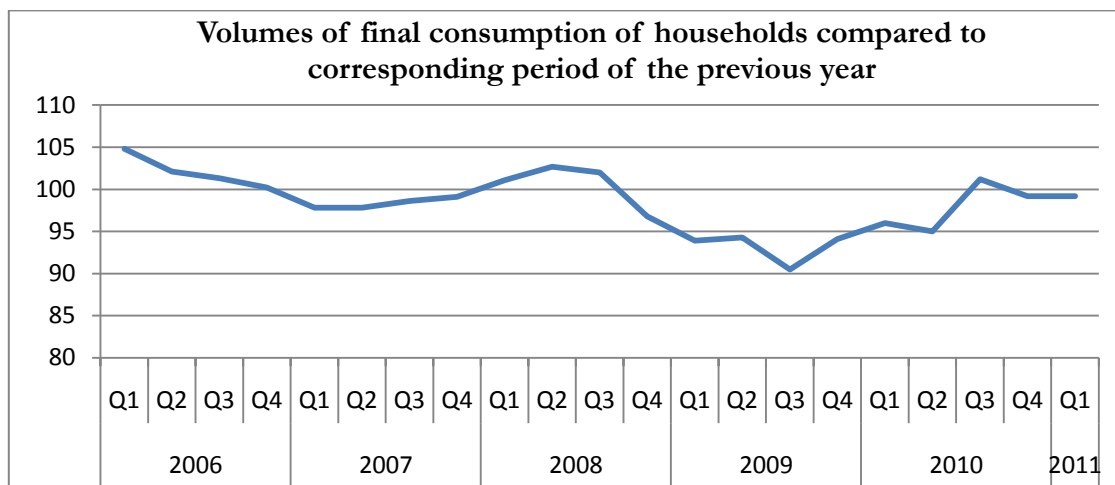
Since the middle of 2010, the process of narrowing the gap between the Hungarian and EU growth figures and a subsequent convergence to the growth averages of the EU 27 has been the key trend. If the structural reforms of the government can be successfully completed, the potential growth rate of the Hungarian economy will presumably rise and in the long term we can enjoy a growth rate above the EU average.

### Household consumption, retail industry

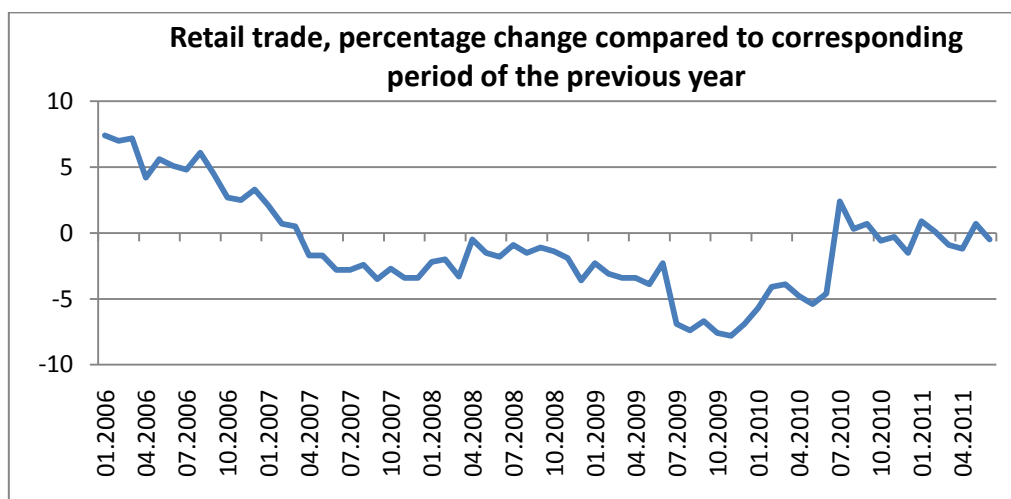
Analyzing the consumption trends of households, we can conclude that **signs of stabilization began to emerge in the last three quarters (from mid-2010)** in this crucial element of GDP.



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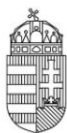
The volume of retail trade had fallen significantly since the end of 2006. **From July 2009, the decline had intensified** and the indicator in question hit the bottom in November 2009 with a fall of 7.8%, turning **positive sharply by 2.4% in July 2010**. During the months after that retail trade **stabilized and oscillated** between -1.5% and 0.9%.



*Source: Eurostat*

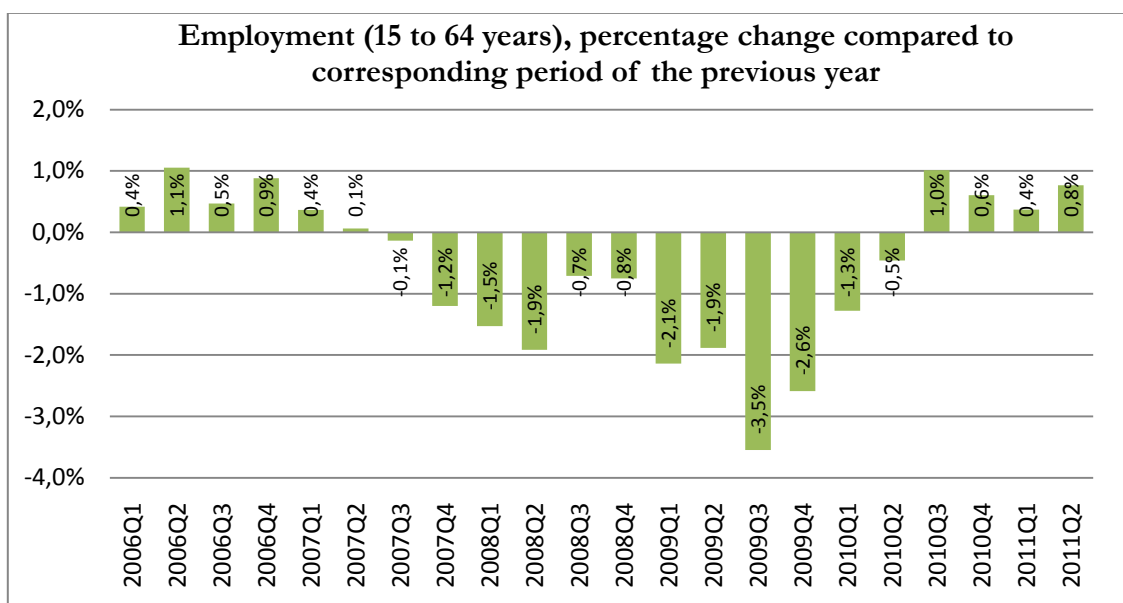
### Labour market trends – activity is highest in ten years

There have recently been positive trends in the labour market: **the activity rate of the population aged 15-74 has reached 56%, the highest since 2001**. In the past couple of quarters there have been **some obviously positive tendencies in the number of jobs**. **By the**



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second quarter of 2011 the number of people employed has increased by 75 200 and, according to the latest data, in May-July 2011 it was followed by a rise of 23 400 people. Therefore, the number of jobs this year has risen by **almost 100 000** to 3 800 200, some of which are, however, seasonal jobs. Comparing the changes to the same period last year, data indicate a **constant rise since Q3 2010**. In May-July 2011, there was an increase of 1.1% relative to the same period in the previous year, which had been unprecedented since Q2 2006.

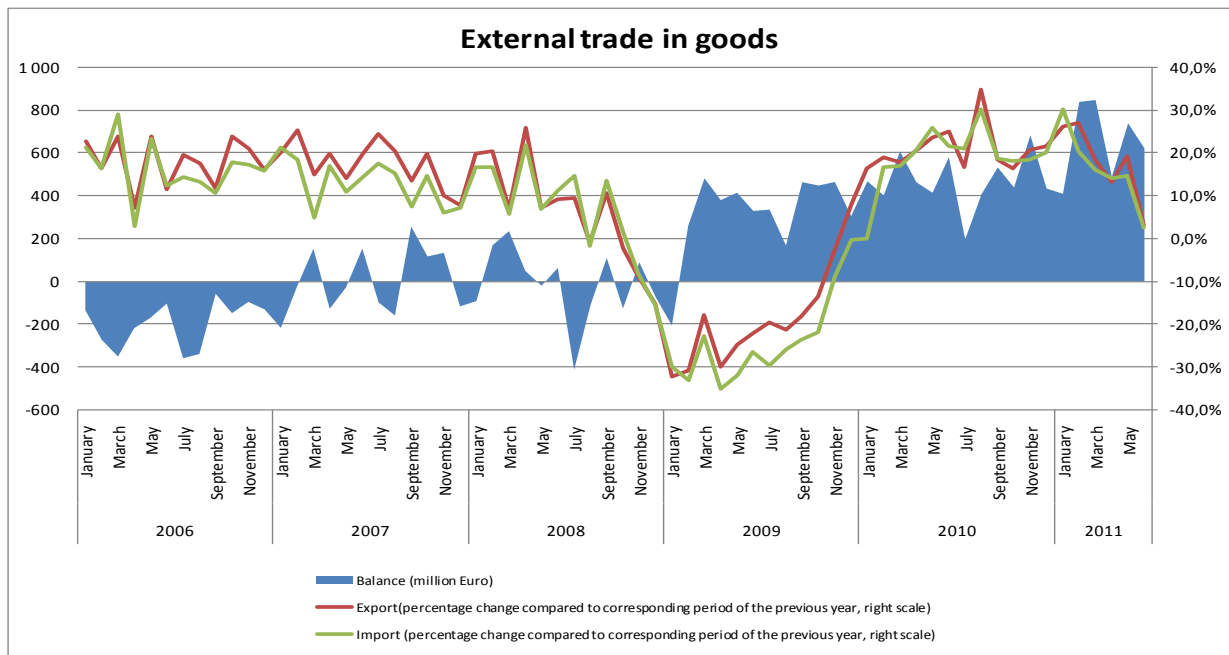


### Foreign trade position of Hungary

The crisis has had a **negative impact on the dynamics of both exports and imports**, but as the volume of exports declined less than that of imports, **foreign trade balance has been improving**. Between Q2 2009 and Q3 2010, the growth rate of both exports and imports improved constantly relative to the same period a year before, but the balance had an increasing surplus. According to the data of the National Bank of Hungary, **in March 2011 the foreign trade balance surplus reached a record of 850.1 million EUR**. Although there was some slight decrease in Q2 2011 in the dynamics of exports and imports, **the balance is still positive**.

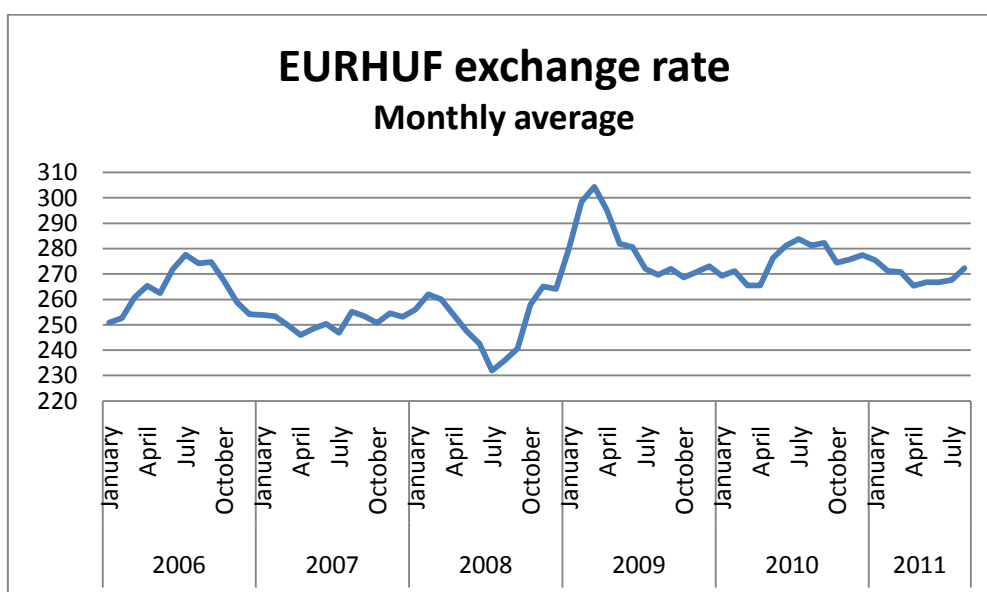


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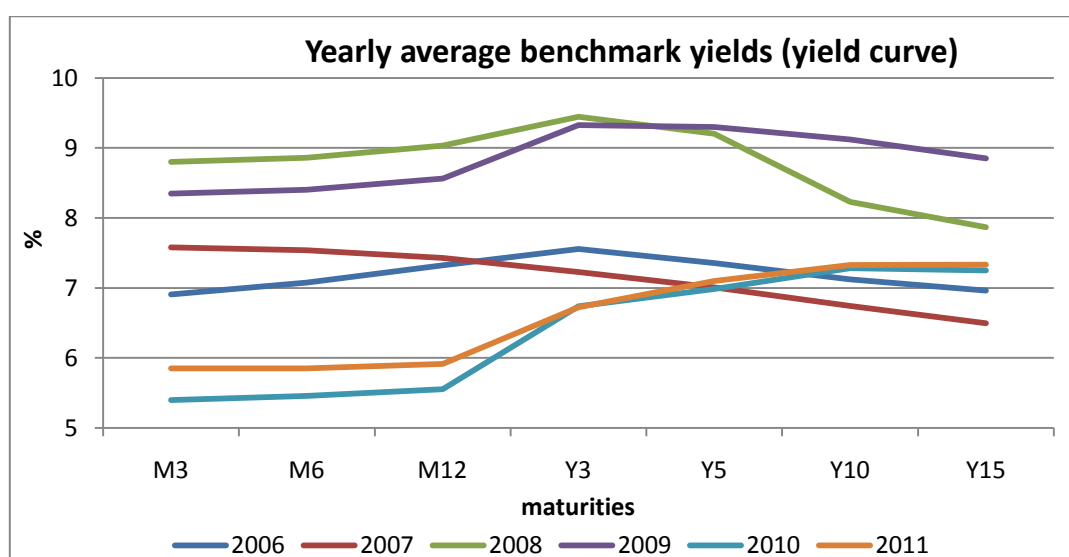
### Money market trends

Money markets have given a vote of confidence to the Hungarian economic policy. One of the indicators showing this has been the **solid EUR/ HUF exchange rate**, even during the money market crash this summer. As the following chart demonstrates, although the exchange rate differential had been **more than 50 HUF** between the end of 2008 and the beginning of 2009, during this summer this fluctuation was hardly 10 HUF.

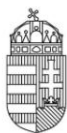




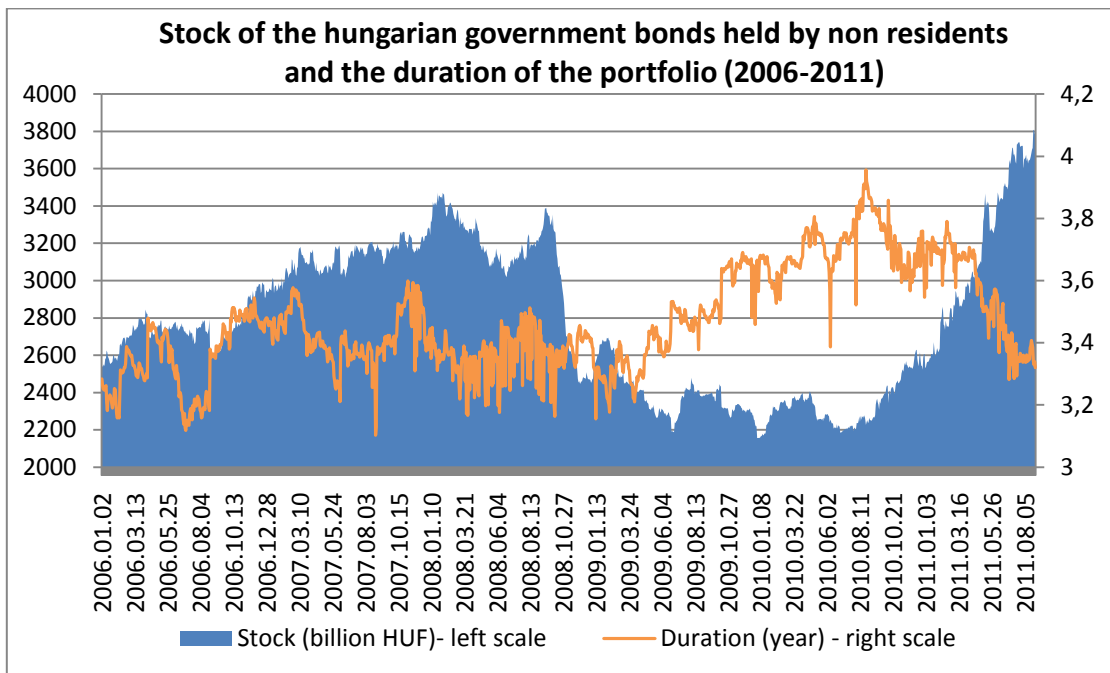
Analyzing annual average yields, it is obvious that **2011 was characterized by the pre-crisis yields of 2006**. Consequently, currently when the West is being shaken by sovereign default fears, **Hungary is financed by the market at such rates which were typical of the period when neither public debts nor economic recession had been considered a meaningful risk factor yet**. As relative to the averages of 2008 and 2009 yields are currently several basis points lower, they can also **improve the budget by billions**.



The value of Hungarian sovereign bonds held by foreigners increased from **2 500bn HUF in 2006 to 3 100-3 200bn HUF in the end of 2008**. The average duration of the portfolio (weighted average remaining maturity) was 3-3.5 years in this period. In 2008, **as the crisis struck, the value of the portfolio fell below 2 500bn HUF again, the average duration decreased somewhat and after that it began to rise sharply**. In 2010, at the signs of recovery, maturity increased parallel to a constant value of securities and **after the Széll Kálmán Plan was announced the value of bonds held by foreigners began to rise significantly**. Although due to the latest anomalies in the global market average maturities declined again, the value of the portfolio continued to increase.



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