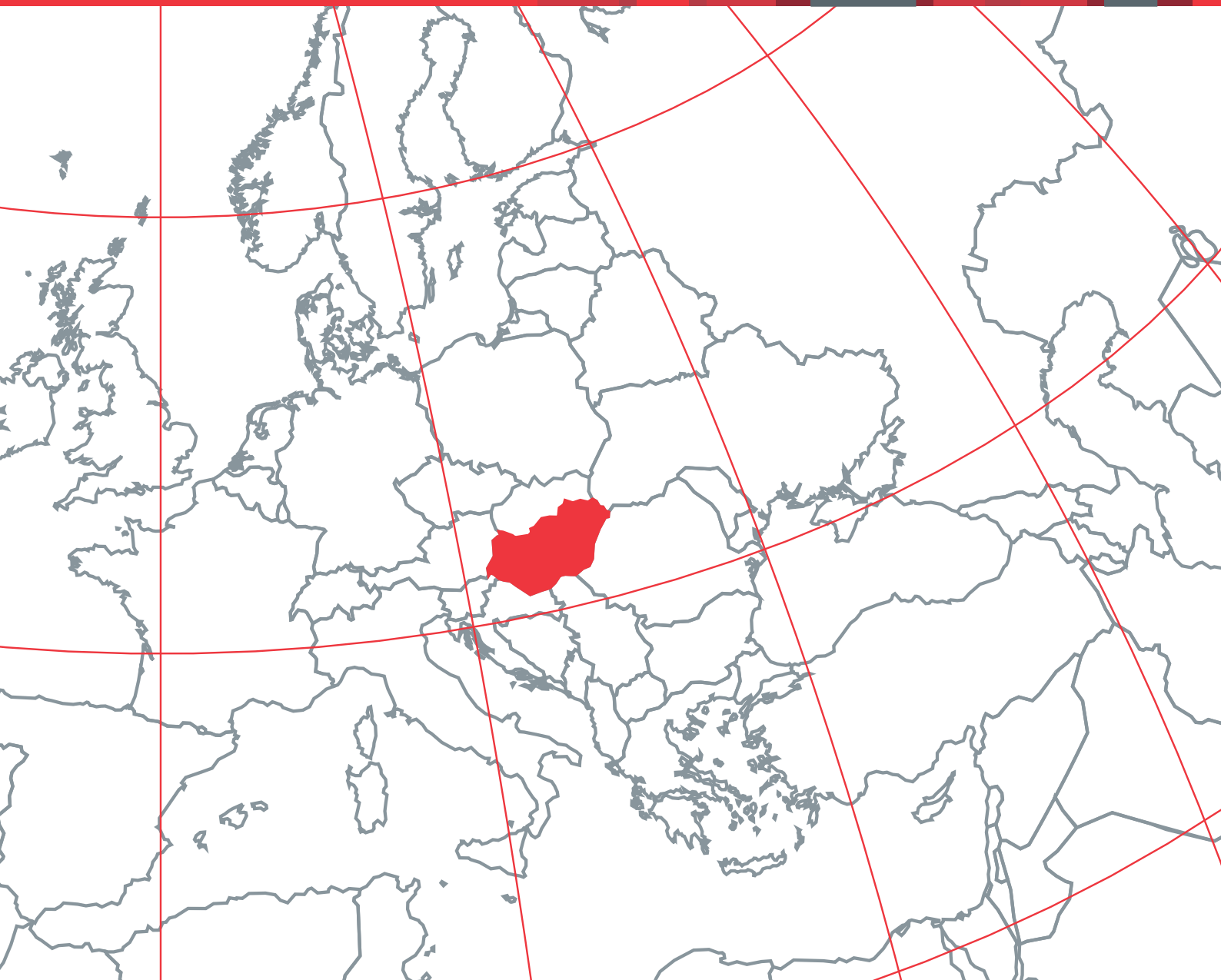


Atradius Country Report

Hungary – March 2011



Overview

General information

Capital:	Budapest
Government type:	Parliamentary democracy
Currency:	Forint (HUF)
Population:	9.9 million
Status:	Upper middle income country (GDP/capita: US\$ 13,112 in 2011)

Most important sectors (% of GDP, 2009)

Services:	65 %
Industry/mining:	32 %
Agriculture:	3 %

Main import sources (2009, % of total)

Germany:	25.1 %
Russia:	7.3 %
China:	6.4 %
Austria:	6.1 %
The Netherlands:	4.8 %

Main export markets (2009, % of total)

Germany:	25.7 %
Italy:	5.7 %
UK:	5.4 %
France:	5.4 %
Rumania:	5.3 %

Main expenses of foreign exchange

Machinery and equipment (52 %), other manufactured products (32 %), fuels/energy (10 %)

Main sources of foreign exchange

Machinery and equipment (62 %), other manufactured products (27 %), food products (6 %), tourism

Key indicators

	2007	2008	2009	2010*	2011**
GDP (US\$ million)	138,366	154,220	128,966	130,540	129,812
Real GDP growth (%)	1.0	0.6	-6.3	1.0	2.0
GDP per capita (US\$)	13,795	15,407	12,910	13,186	13,112
Inflation p.a. (%)	7.9	6.1	9.6	4.8	3.4
Fiscal balance (% of GDP)	-5.0	-3.7	-4.4	-3.9	-2.9
Total foreign debt (US\$ million)	138,387	169,800	160,000	149,500	139,200
Foreign debt/GDP (%)	100	110	124	115	107
Foreign debt/XGS (%)	112	119	144	117	99
Short-term debt/inter. reserves (%)	68	n.a.	n.a.	n.a.	n.a.
Debt service ratio (%)	32	31	40	33	29
Current account balance (US\$ m.)	-9,081	-10,808	441	-1,115	-3,253
Current account/GDP (%)	-6.6	-7.0	-0.3	-0.9	-2.5
Nom. exchange rate to US\$ (average)	184	172	202	207	218
International reserves (US\$ million)	23,222	34,667	43,356	45,313	46,017
In months of merchandise imports	3.0	4.0	6.7	6.7	7.8

*estimate **forecast

Source: Economist Intelligence Unit (EIU), International Monetary Fund (IMF)

Political situation: Government with a two-thirds majority

Head of state: President Pal Schmitt (since August 2010)
Head of government: Prime Minister Viktor Orban (since May 2010)
Form of government: Centre-right Fidesz party governs with an absolute majority in parliament

Internal situation

In the April 2010 parliamentary elections the centre-right Fidesz party gained a landslide victory over the ruling Socialists, achieving a two-thirds majority in parliament (262 of the 386 seats): the strongest mandate a party has yet gained in post-communist Hungary. This large majority enables the government to amend the constitution without the support of the opposition.

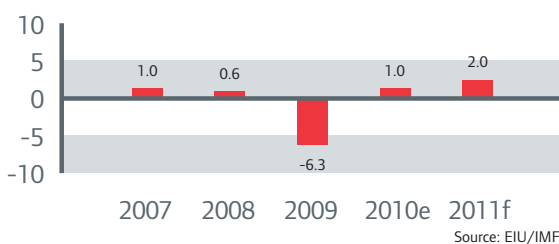
International relations

A new media law launched by the Orban administration, which took effect on 1 January 2011, drew widespread international criticism, as the requirement of 'balanced' media coverage and compulsory registration processes for media outlets raised fears that the authorities aim to curb freedom of speech. The EU commission warned the Hungarian government that the new law is incompatible with existing EU laws and that it would resort to legal action if unless the law was changed. In early February, Budapest gave an assurance that it would amend the media law to comply with EU norms. Those changes to three main areas of the media law were accepted by the EU commission at the end of February, and finally the Hungarian parliament passed the required amendments in early March.

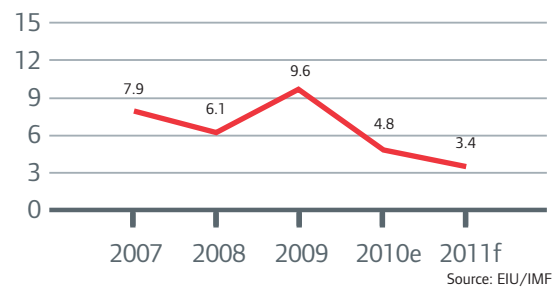
Hungarian minorities in Romania, Slovakia and Serbia occasionally give rise to some tensions between Budapest and its neighbours.

Internal economic situation: Weak recovery after deep recession

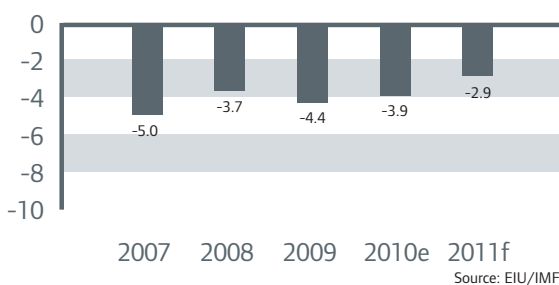
Real GDP growth (%)



Inflation p.a. (%)



Fiscal balance (% of GDP)



General situation

After years of private and public sector overspending, resulting in high GDP growth but also in high twin deficits, the economy fell into a deep recession in 2009. GDP contracted 6.3 %, as domestic demand-oriented sectors were hit by budgetary tightening while industrial exports suffered as a result of the economic meltdown in the eurozone, as Hungary is heavily dependent on its exports to other EU countries.

In 2010, growth resumed, especially in the second half of the year, with year-on-year GDP increases of 1.7 % in Q3 and 1.8 % in Q4, mainly as a result of improved industrial exports. However, domestic demand remained subdued, as households and businesses alike continued to rein in spending. The reasons for this were a shortage of new funding, high private sector debt obligations denominated in foreign currency (mainly in Euros or Swiss Francs), budgetary tightening, lower real incomes and the high unemployment rate, which by January 2011 stood at 11.2 %.

After peaking at 9.6 % in 2009, inflation fell, although the benefits were negated by rising taxes and public sector tariffs. From 4.7 % in December 2010, inflation decreased to 4.0 % in January 2011. The National Bank of Hungary has squeezed consumer prices further by increasing its base rate by 50 basis points since November 2010: to 6 % in January 2011.

The banking sector has a weak loan portfolio, with high foreign exchange risk and a non-performing loan ratio (NPL) of above 10 %. 90 % of the banking sector is foreign owned.

Economic policy: populist and market-adverse measures have caused concern

In October 2008 the forint plunged in the face of increasingly adverse global market sentiment against the Hungarian currency. A massive multilateral bail-out package by the IMF and the EU was introduced to shore up the forint and deeply eroded international reserves. The standby agreement totalled US\$ 25.8 billion, of which US\$ 15.9 billion was supplied by the IMF under specific conditions. The package spanned 17 months, with US\$ 6.3 billion available immediately and the remainder disbursed in five instalments, subject to quarterly reviews.

IMF-monitored fiscal consolidation led to a reduction in the budget deficit from its record 9.3 % of GDP in 2006 to 3.9 % of GDP in 2010, as the former government introduced further austerity measures, curbing public sector spending even more and raising taxes - especially VAT.

While prime minister Orban's parliamentary majority would enable him to take the drastic measures needed to tackle Hungary's structural economic problems, his economic policy has so far failed to satisfy the financial markets, rating agencies and IMF. In fact, the new government's populist economic measures have actually caused further concern in international financial circles:

In the summer of 2010, the new government resisted IMF demands to impose more long lasting cuts in state spending, arguing that no further austerity measures were possible, and refused to negotiate a new stand-by agreement with the IMF (the stand-by loan agreement having expired in October 2010). The IMF and EU also criticised the introduction of additional taxes on banks and corporates in mid 2010 that were intended to improve the fiscal balance by bringing in an additional Euro 700 million within three years. Those mainly affected by the taxes are foreign-owned financial institutions, retail, telecommunication and energy companies.

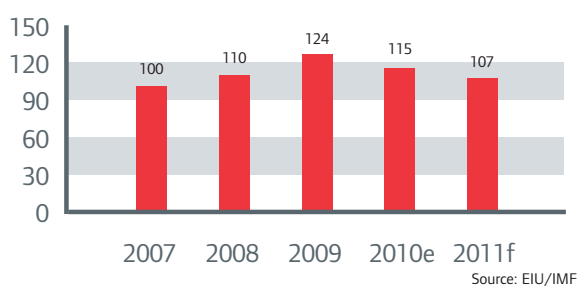
Another move away from a solid fiscal policy was the government's decision, in November 2011, to transfer private pension funds worth US\$ 14.6 billion to the public sector, thereby reversing one of the major privatisation measures of the late 1990s. The government plans to use the pension fund to pay current state pensions and to cut debt as it seeks to reduce the budget deficit below 3 % of GDP in 2011. However, any improvement achieved in this way would be artificial and short-lived, as the structural fiscal position would remain unchanged while long-term risks would increase.

As a consequence of the market-adverse and controversial measures taken by the new government, Hungary's credit rating was downgraded 2 notches to Baa3, on the verge of 'junk' status.

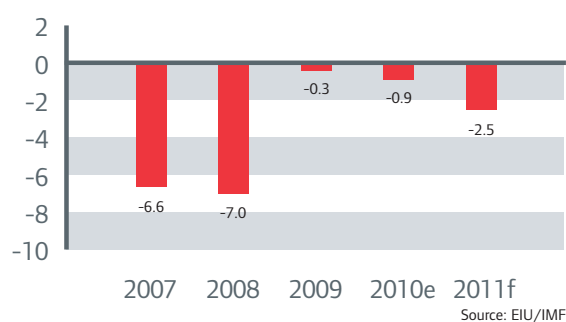
At the same time, tensions have increased between the government and the central bank over fiscal and monetary policy. At the end of 2010 the Central Bank's governor openly criticised the government for its plans to lower taxes, as this would further jeopardise the budget situation and fuel inflation. In response, prime minister Orban blamed the Central Bank's policy of raising rates to counter inflation as counterproductive to any economic recovery. This political pressure on the central bank's board was compounded at the end of February when the government increased its influence on the Monetary Policy Council of the Central Bank, thus raising additional concerns about the independence of the bank and its monetary policy.

External economic situation: Sovereign downgrading

Foreign debt/GDP (%)



Current account/GDP (%)



Foreign debt

Level: After years of steeply rising private sector debt, this declined to US\$ 139 billion by the end of 2010 but is still very high: at 107 % of GDP, 99 % of exports of goods and services

Structure: Reasonable

Debt service ratio: High: 29 % in 2011, approximately 50 % including short-term debt

Remarks:

The 5th review of the standby package was completed in March 2010, but Hungary did not draw on the tranche of US\$ 1.1 billion. Negotiations with the IMF and the EU ended without result (see above).

Solvency continues to be weak with unfavourable GDP and export ratios. The debt service ratio remains high, strongly suggesting that Hungary needs to foster better relations with the international financial world. In this respect, the latest economic policies are reason for concern about Hungary's willingness to comply with international standards and possibly even to honour its foreign debt obligations.

Balance of payments

Trade balance: Positive

Current account: Rising deficit in 2011 (to 2.5 % of GDP in 2011)

Capital account: Positive

Total Account: Lower surpluses

Remarks:

The external position has improved considerably as a result of the recession, with the large current account deficit dropping sharply in 2009, as imports decreased more than exports. More recently, a resurgence in imports has contributed to renewed current account deficits in 2010 and 2011. However, the large deficits seen in the years up to 2009 will not return in the near future. In February 2008 the National Bank abandoned the forint trading band, leaving the currency exposed to increased market sentiment volatility and an effective depreciation against the euro.

International reserves

In months of imports (cif): Increase to almost 8 months in 2011

Prospects: Very uncertain

Internal economic situation

In 2011, more robust GDP growth of 2% is predicted, but the outcome depends on an improvement in consumer demand and further export consolidation. While there are signs of a rebound in private consumption, any recovery remains fragile. Credit losses have increased recently, as households with foreign exchange-denominated mortgage debt and banks have been hit by the strong Swiss Franc.

Payment delays are still prevalent in all sectors, including public buyers such as municipalities and ministries. Construction and transport in particular are notorious for their very late payment record. After a 17% year-on-year increase in business insolvencies 2010, we expect a further rise in the coming months, with construction, food, consumer durables, IT, and retail sales the main victims.

After some easing of lending conditions in early 2010, we expect bank lending to again become tighter and more expensive in 2011, due to the new tax imposed on banks. Financial institutions will either restrict lending or pass the tax burden on to their clients. However, small and medium-sized enterprises (SMEs) should be able to access loans from public sources more readily than in the past, thanks to the New Széchenyi Plan (a 29-point government action plan designed to boost the economy), which it is said will provide forint 1 trillion of loans from both EU subsidies and national financing.

Economic policy

After a downgrade by Moody's, Hungary's sovereign rating is on the verge of a junk status. Without IMF/EU support, Hungary's standing on the financial markets largely depends on market confidence. In a move to regain this shaken confidence, on 1 March 2011 the government announced a comprehensive budget plan, aimed at reducing public debt from 80% of GDP in 2010 to 66% of GDP in 2014, and narrowing the budget deficit to 1.9% of GDP, with budget savings of US\$ 4.6 billion from 2013. The plan includes a delay in cutting corporate income tax, an extension of the controversial bank tax beyond 2012, tighter welfare and retirement rules, reduced pension spending and a boost to employment.

However, the administration has yet to provide details of how these measures will be implemented and how expenditure will be limited in the future, prompting a rather lukewarm response from international investors. Hungary's economic problems need a structural approach rather than just austerity measures.

The new budget plan will not change the fact that the government's recent economic policy measures - ending the IMF programme, bank taxes, pension fund transfer, its confrontation with the central bank - have damaged its previously solid reputation on the international markets, weakening its reliability as a debtor and the long-term budgetary solidity. Sovereign prospects are therefore negative.

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